

GILAT SATELLITE NETWORKS LTD.

EXHIBITS TO THE ANNUAL REPORT

FOR THE FISCAL YEAR

ENDED DECEMBER 31, 1999

AS FILED ON FORM 20-F

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EXHIBIT INDEX

Exhibits

- 2.1 Consent of Kesselman & Kesselman
- 2.2 Consent of Berman, Hopkins,
Wright & Laham, LLP

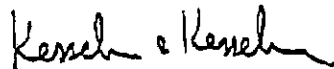
EXHIBIT 2.1

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Kesselman & Kesselman
Certified Public Accountants (Isr.)
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Tel Aviv 68125 Israel
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CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Registration Nos. 333-10092, 333-08026 and 333-96630) and Form F-3 (Registration Nos. 333-09824, 333-07446 and 333-07440) of our report dated February 27, 2000 (except for notes 8, 10b(5), 16b(1) and 16c for which the date is June 5, 2000), relating to the financial statements of Gilat Satellite Networks Ltd., included in this Annual Report on Form 20-F of Gilat Satellite Networks Ltd., for the year ended December 31, 1999. We also consent to the reference to our firm under the heading "Selected Consolidated Financial Data".



Kesselman & Kesselman
Certified Public Accountants (Isr.)

Tel Aviv, Israel
June 29, 2000

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Kesselman & Kesselman is a member of PricewaterhouseCoopers International Limited, a company limited by guarantee registered in England and Wales.

EXHIBIT 2.2

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BERMAN HOPKINS
WRIGHT & LAHAM, CPAs, LLP

CERTIFIED PUBLIC ACCOUNTANTS • BUSINESS CONSULTANTS • PROFIT ADVISORS

James A. Wright, Jr.
James S. Laham

Lewis H. Berman (retired)

John R. Hopkins
Ross A. Whitley

Emily E. Arnold (retired)

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

Gilat Satellite Networks, Ltd.
21 Yegia Kapayim St.
Daniv Park, Kiryat Arye
Petah Tikva 49130
Israel

We hereby consent to the incorporation by reference of our report dated February 4, 2000 relating to the audit of the financial statements of Gilat Florida Inc. (a wholly-owned subsidiary of Gilat Satellite Networks, Ltd.) as of December 31, 1999 and 1998 and for the three years ended December 31, 1999, included in this Annual Report on Form 20-F, into the Registration Statements of Form S-8 (Registration Nos. 333-10092, 333-08026 and 33-96630) and on Form F-3 (Registration Nos. 333-09824, 333-07446 and 333-07440). We also consent to the reference to our firm under the caption "Selected Consolidated Financial Data".

June 30, 2000
Melbourne, Florida

*Berman Hopkins
Wright & Laham, CPAs, LLP*

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Acquisition of SpaceNet, p. 65

\$ 191 mm / 5 mm shares = \$ 38.20
per share

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valuation of p. 67

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Gilat Satellite Networks, LLC.

Form 20-F

1998

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F-17 Acquisition of Gilat Florida, 1996

 ↳ record write-up charges in 1996 of \$ 7,771,000

 ↳ pooling of interests

F-18 Sale of GNT

As filed with the Securities and Exchange Commission on June 30, 1999

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1998

Commission file number 0-21218

GILAT SATELLITE NETWORKS LTD.

(Exact name of Registrant as specified in its charter)

ISRAEL

(Jurisdiction of incorporation or organization)

Gilat House, Yegia Kapayim Street, Daniv Park, Kiryat
Arye, Petah Tikva, 49130 Israel
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

NONE
(Title of each class)

Securities registered or to be registered pursuant of Section 12(g) of the Act:

Ordinary Shares, par value NIS 0.01 per share
(Title of class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

NONE
(Title of class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock at the close of the period covered by the annual report:

As of December 31, 1998, Registrant had 16,162,070 Ordinary Shares, NIS 0.01 par value per share outstanding.

As of June 16, 1999, Registrant had 20,969,162 Ordinary Shares, NIS 0.01 par value per share outstanding.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

Indicate by check mark which financial statement item the Registrant elected to follow:

Item 17 _____ Item 18 X

PART I

ITEM 1: DESCRIPTION OF BUSINESS

General

Gilat Satellite Networks Ltd. ("Gilat") is a leading provider of products and services for satellite-based communications networks. We design, develop, manufacture, market and service products that enable complete end-to-end telecommunications and data networking solutions based on very small aperture terminal ("VSAT") satellite earth stations, related central station (hub) equipment and software. With our acquisition of Spacenet Inc. and its subsidiaries and certain foreign affiliates from GE American Communications, Inc. ("GE Americom"), a subsidiary of General Electric Corporation, and certain affiliates, on December 31, 1998, we now provide service offerings which include access to satellite transponder capacity, installation of network equipment, on-line network monitoring and network maintenance and repair services.

Our networks are primarily used for:

- on-line data delivery and transaction-oriented applications including point-of-sale (for example, credit and debit card authorization), inventory control and real time stock exchange trading
- telephone service in areas that are underserved by the existing telecommunications services or in remote locations without service
- Internet Protocol ("IP") based networking applications such as corporate intranets, corporate training and other broadband multicasting applications

Through December 31, 1998, we sold more than 110,000 interactive VSATs. According to Comsys, a leading industry source, Gilat has approximately 30% of the worldwide interactive VSAT market. Comsys also reports that in 1998, our market share was approximately 40% of the total interactive VSATs for which contracts were awarded worldwide. Major users of our products and services include the United States Postal Service, British Petroleum, John Deere, First Union Bank, PageNet, Rite Aid, Peugeot-Citroën and Telkom South Africa.

We distribute our products and services worldwide through our own direct sales force, service providers and agents and, in certain circumstances, joint ventures, alliances, and affiliated companies. Our distribution network and service offerings were enhanced by the Spacenet acquisition, which added a significant existing customer base as well as a distribution infrastructure in the United States, Europe, Asia and South America. As a result of the Spacenet acquisition, GE Americom, together with its affiliates, has become our largest shareholder with approximately 23.84% of our shares outstanding as of June 16, 1999.

Satellite-based communications networks offer several advantages over ground-based communication facilities. Among these advantages are the following:

- independence from telecommunication companies and other network providers
- exceptional reliability
- consistent and rapid response time in comparison to dial-up lines

- rapid deployment of networks and flexibility in their configuration, integration and location
- a versatile platform which allows for the provision of multiple applications and services
- cost savings over competing technologies for many applications

Gilat was incorporated in Israel in 1987. Gilat's corporate headquarters, executive offices and research and development, engineering and manufacturing facilities are located at Gilat House, Yegia Kapayim Street, Daniv Park, Kiryat Arye, Petah Tikva 49130, Israel. The telephone number is (972)3-925-2000.

Unless the context otherwise requires, references in this annual report on Form 20-F to "Gilat", "we", "our" refer to Gilat Satellite Networks Ltd. and its subsidiaries. Our subsidiaries include Gilat Satellite Networks, Inc., Gilat Satellite Networks (Europe) S.A, Gilat Satellite Networks (Holland) B.V., Gilat Satellite Networks (Hong Kong) Ltd., Gilat Florida Inc. ("Gilat Florida") and Spacenet Inc. and its subsidiaries and certain foreign affiliates ("Spacenet").

The name "Gilat™" and the names "TwoWay™", "OneWay™", "FaraWay™", "DialAway™", "SkySurfer™", "SkyBlaster™", "Skydata®", "ISAT®", "WebSat™", "Clearlink™" and "Skystar Advantage®" appearing in this report on Form 20-F are trademarks of Gilat and its subsidiaries. - GSAT® is a registered trademark of GTECH Corporation. Other trademarks appearing in this annual report on Form 20-F are owned by their respective holders.

Acquisition of Spacenet

On December 31, 1998, we completed the acquisition of Spacenet, a company engaged in providing VSAT-based network services. Prior to the acquisition, Spacenet had been our largest customer and a wholly-owned subsidiary of GE Americom, an indirect subsidiary of the General Electric Corporation. The transaction was completed pursuant to an Agreement and Plan of Merger entered into on September 25, 1998, between Gilat, GE Americom, and Spacenet. We acquired Spacenet from GE Americom in exchange for 5 million shares of newly issued Gilat ordinary shares. The acquisition was structured as a merger intended to qualify as a "tax-free" reorganization. See Item 13: "Interest of Management in Certain Transactions—Merger-Related Agreements—The Tax Matters Agreement."

As of June 16, 1999, GE Americom owns approximately 23.84% of our outstanding ordinary shares, and is our single largest shareholder. GE Americom has the ability to nominate up to two Directors to our Board as long as it owns at least 50% of the shares it received as part of the transaction. GE Americom has also agreed to certain "stand-still" provisions and restrictions on the transferability of its shares. See Item 13: "Interest of Management in Certain Transactions -Merger-Related Agreements-The Shareholders' Agreement."

Prior to the acquisition, Spacenet was the single largest customer for our equipment. Spacenet purchased our VSAT products in order to incorporate them into Spacenet's VSAT-based network service offerings. Aggregate sales to Spacenet represented approximately 28%, 34% and 45% of Gilat's total sales in 1996, 1997 and 1998, respectively.

The acquisition of Spacenet has enabled Gilat to expand from primarily manufacturing and selling VSAT equipment to becoming a provider of complete end-to-end telecommunications and data networking solutions based on VSAT satellite earth stations. We believe that this acquisition greatly enhances our ability to develop and offer new products and services and to maintain our position as one of the leaders in the VSAT industry, especially since our major competitor is also a provider of both

equipment and services. The Spacenet acquisition has added a significant customer base in the United States, Europe, Asia and South America and access to Spacenet's other relationships in the global VSAT industry.

As part of the acquisition, we entered into several significant agreements with GE. See Item 13: "Interest of Management in Certain Transactions—Merger-Related Agreements."

In addition, as part of the Spacenet acquisition, we acquired certain advanced VSAT technology developed under the name Turbosat. We plan to market this technology under our own name. We believe that there is no VSAT system which is currently commercially available that has the capabilities purchased and that, upon our completion of the development of this technology, we will be able to offer the most technologically advanced VSAT in the market. We believe that this technology, as well as other patents and trademarks acquired including the right to use the GE logo for three years, further strengthen our market position.

Public Offering

In February 1999 we completed a public offering of 5,456,750 Ordinary Shares, of which 4,711,750 Ordinary Shares were sold by Gilat and 745,000 by certain shareholders (the "Offering"). As of June 16, 1999, we have 20,969,162 Ordinary Shares outstanding.

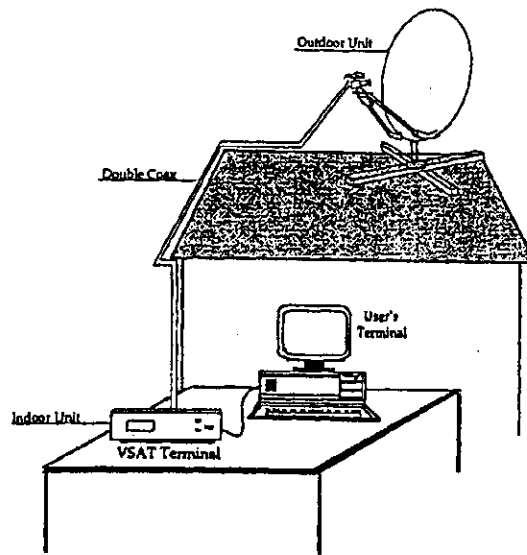
Industry Background

VSAT Industry Background

The emergence of the Very Small Aperture Terminal (VSAT) in the 1970s marked the beginning of a new era in satellite communication. A VSAT network consists of:

- several dozen to several thousand VSAT remote sites with small antennas
- a large central earth station called a hub, which includes a large antenna and enables the connection of all the VSATs in the network
- satellite transponder capacity

A VSAT remote site includes an indoor unit, an outdoor unit and a small antenna. The indoor unit usually fits on a desktop (much like a modem) and contains the circuitry that activates the communications link between the user's equipment and the satellite. The outdoor unit includes a small antenna, usually 2 to 6 feet, that can be mounted on an end-user's roof, ground or wall and electronic equipment that transmits and receives signals to and from the satellite transponder.



VSAT on-site equipment

The hub for a VSAT network consists of a large dish antenna (4.5 to 11 meters) and radio frequency electronics equipment to allow signals to be transmitted between the hub and the satellite transponder. A hub also includes electronic equipment to provide for satellite communications, protocol support and network management functions.

Satellite transponder capacity is available on existing satellites positioned in geostationary orbit (at 35,800 km above the equator). Once in orbit, a satellite beam can cover a geographic area the size of the continental United States or Western Europe. This coverage area is known as the satellite's footprint. The satellite receives information from a VSAT, amplifies it, and transmits it back to earth on a different frequency. A single satellite transponder has a capacity of approximately 100 million bits/seconds of information. This means that if the transponder is accessed for only 90 seconds per day, more than 1 billion bytes of data, the equivalent of 865,000 double-spaced pages, would be transmitted.

The current generation of high power Ku-band satellites and sophisticated VSAT earth stations are particularly well suited to provide high speed business communications services. The use of the Ku-band frequencies (as opposed to the C-band used by older generations of satellites) offers reduced interference with ground communications. This enables satellites to use the higher broadcasting power necessary to support VSAT earth stations and makes it cost-effective to transmit to or among numerous locations. With increasing satellite power and the latest generation of VSAT software, VSAT earth stations are becoming smaller and less expensive, reducing overall network cost.

Before the emergence of VSATs, commercial communication via satellite was very costly because it required an expensive ground terminal and a very large dish antenna. Satellite-based communications solutions were therefore limited to only those large companies which could afford them. In contrast, VSATs are significantly less expensive than other satellite solutions partly because they do not require

end-users to dedicate staff specialists or make a sizable infrastructure investment.

VSAT networks also offer several advantages compared to ground-based communications networks:

- Excellent and dedicated transmission quality
- The capability of transmitting extremely large data flows
- Fixed transmission costs, insensitive to distance or the number of receiving stations
- Rapid and cost effective deployment in geographically isolated regions like mining areas and developing countries.

Market Opportunity

The market for communication network products and services has experienced rapid growth in recent years, and we believe that it will continue to do so into the future. Some of the key factors responsible for this growth include:

- rapidly growing demand for communications capacity driven by the increase in bandwidth-intensive applications;
- continuous technological advances which are broadening applications for, decreasing the cost of, and increasing the capacity of, both satellite and ground-based networks;
- global deregulation and privatization of government-owned telecommunications monopolies which allow for greater access to communications alternatives.

The above trends have benefited a range of alternative technologies such as switched digital networks (ISDN service), frame relay and asynchronous transfer mode systems, as well as VSAT-based systems. The growth in the use of VSATs has been strong and consistent. According to industry sources, the installed VSAT base grew from 8,000 terminals in 1986 to approximately 375,000 terminals in 1998.

We provide VSAT-based communications solutions to target growth opportunities in three rapidly expanding market segments, each of which is further described below:

- data networks for:
 - interactive applications such as consumer ATM, credit card, debit card and lottery transactions, retailer and manufacturer inventory control and utilities' monitoring and control systems for power lines and pipelines
 - unidirectional applications such as data broadcasting and paging systems
- telephone service offerings in remote and rural areas and in underserved urban areas, primarily in developing countries
- IP-based applications such as private corporate networks for business television, video teleconferencing, employee training, publishing information and sharing data among employees, vendors and customers as well as Internet access.

VSAT Data Networks

The significant growth in interactive data network services during the last decade has led to increased demand for satellite-based networks. VSAT and satellite technology is particularly well suited to those data networks which need to (i) reach many locations over vast distances simultaneously, (ii) solve a "last mile" or congestion problem, allowing high bandwidth access in areas currently limited to slow connections like copper wire, (iii) transmit to remote locations and to emerging markets where the terrestrial telecommunications infrastructure is not well developed, and (iv) rapidly provide services across a large geographic area served by multiple terrestrial providers.

Due to the above advantages, corporate users are increasingly realizing the benefits of VSAT networks. As a result, VSAT networks are experiencing significant growth as a substitute for, or complement to, ground-based services such as frame relay and ISDN.

VSAT-Based Telephone Service

In a large number of remote, rural and urban areas, primarily in developing countries, there is limited or no telephone service due to inadequate telecommunications infrastructure. In these areas, VSAT networks are able to utilize existing satellite infrastructure to rapidly provide high quality cost-effective telecommunications solutions. In contrast to ground-based networks, VSAT networks are simple to reconfigure or expand, relatively immune to difficulties of topography and can be located almost anywhere. Additionally, VSATs can be installed and connected to a network in a matter of hours and seldom require maintenance.

As a result of the above advantages, the market for VSAT-based telephone service, consisting of both large companies which require private networks to provide communications between branch offices and corporate headquarters, and service providers targeting rural and residential areas in developing countries that cannot afford basic telephone service, is rapidly growing.

VSAT-Based Internet Applications

While international voice traffic was expected to grow at a rate of 13% annually, from 1996-2000, international data traffic growth is expected to significantly outpace voice traffic growth. One of the key factors contributing to the growth in data traffic is the increasing use of IP-based broadband applications dominated by the Internet. As more businesses evolve from establishing an Internet presence to utilizing securely connected geographically dispersed locations, the demand for high quality IP-based connectivity and value-added services will grow. Industry sources forecast that the U.S. Internet access services market will grow at a rate of over 40% per year to over \$19.0 billion in 2000, with business connectivity and value-added services representing a large portion of that market.

Products and Services

We currently offer three VSAT product lines, each of which is generally incorporated into a VSAT network consisting of a remote terminal linked to a central hub or control center via a satellite. In addition, Spacenet, which we acquired in December, 1998, offers satellite-based network products and services including private communications networks carrying high speed two-way data, Internet, intranet, fax and voice transmission. With the completion of the Spacenet acquisition, we now offer the full range of end-to-end products and services described below.

VSAT Products

The following table sets forth our current product lines:

Products by VSAT Market Segment

Segment	Products/Application	
Data	SkyStar Advantage	ISAT → WebSat
	—Interactive	—Frame Relay
Telephony and Voice	FaraWay	DialAway
	—Satellite Telephony	—Rural Telephony
Internet	SkySurfer	SkyBlaster
	—One-way Internet Access	—Two-way Internet Access

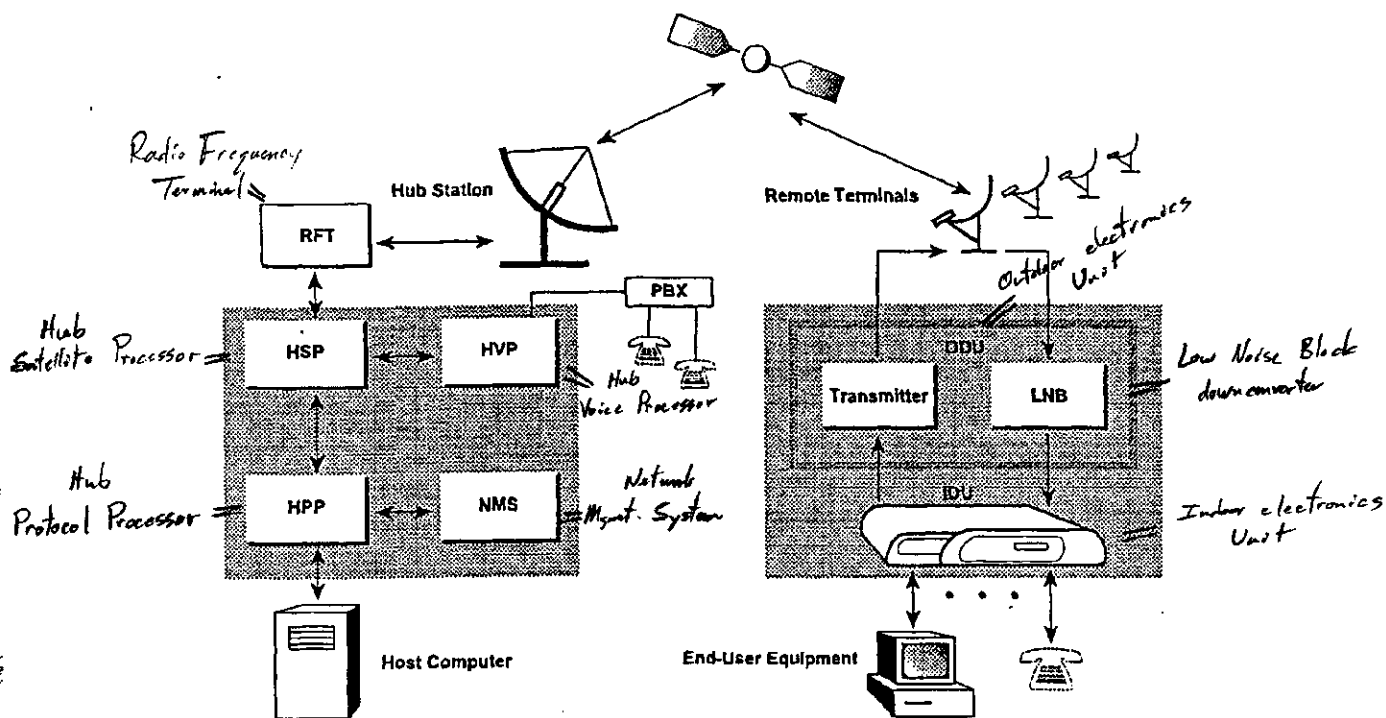
OneWay and Broadcast Receivers
 —Data Broadcast
Also discontinued Clearlink
Also discontinued
Gilat Florida Unidirectional VSAT

We are now focusing on providing one platform for interactive VSAT products and on consolidating our other product offerings to meet current customer demand. We have therefore discontinued our original OneWay product line, as well as several product lines previously marketed by Spacenet and its predecessors (such as the Clearlink product line), although we continue to support existing customers of those products.

Data Delivery Products:

Skystar Advantage VSAT. Our Skystar Advantage VSAT product, when integrated into a network, is used in transaction-oriented, point-to-multipoint satellite communication networks. The Skystar Advantage VSAT is designed to enable reliable and cost-effective interactive communications between a central hub and several tens to several thousand geographically dispersed sites. The applications currently served by our products include the following: credit and debit card authorization for retail sales; point-of-sale information and ATM networks; on-line recording and validation of lottery tickets; prescription verification, inventory control and review of customer profiles; inventory control and delivery scheduling at the manufacturing level; supervisory control and data acquisition networks for oil and gas pipelines; on-line remote stock exchange trading for brokers; distance learning and Internet access. A single voice channel add-on feature is also available. The Skystar Advantage VSAT also permits the delivery of value-added services such as video broadcasting applications which are offered by other vendors.

As of December 31, 1998 we had shipped approximately 69,500 Skystar Advantage VSATs to customers worldwide.



Architecture. As shown above, our Skystar Advantage VSAT product consists of remote terminals, hub equipment and related software. Our remote terminal consists of a small outdoor antenna (typically 0.95 to 1.2 meters in diameter for the Ku-band frequency and 1.8 to 2.4 meters in diameter for the C-band frequency), an outdoor electronics unit ("ODU") and an indoor electronics unit ("IDU"). The ODU receives signals from a satellite transponder using a Low Noise Block ("LNB") frequency down-converter and transmits signals to the satellite transponder using our proprietary frequency up-converter and power amplifier. The IDU incorporates a satellite modem utilizing digital signal processing technology and a powerful central processing unit ("CPU"). The CPU controls communications through the satellite (including the satellite access scheme) and provides the platform for interface to the end-user's remote terminal equipment. The small antenna typically is supplied by a third-party vendor or purchased directly by our customer. We design and manufacture the IDU, design and integrate the ODU and supply that part of the software (the connectivity software) that, among other things, controls the satellite access scheme.

The hub for the network incorporating our Skystar Advantage VSAT products consists of a radio frequency terminal ("RFT") and baseband equipment. The RFT incorporates a large dish antenna (typically 4.5 to 11 meters) and RF electronics equipment (up and down frequency converters, low noise amplifiers and high power amplifiers). The baseband equipment is comprised of the hub satellite processor ("HSP"), hub protocol processor ("HPP") and network management system ("NMS"). The HSP hardware provides the communication connectivity to the remote terminals and the HPP provides the

interface between the HSP and the customer host computer running end-user applications. The NMS monitors and controls all the remote terminals and the hub equipment. We design and manufacture the HSP software and hardware. The RFT is typically provided by third-party vendors. The HPP and NMS are provided by us in the Skystar Advantage network, and by GTECH in its VSAT network, which is known as "GSAT."

Features. Our Skystar Advantage VSAT product utilizes a patented two-dimensional, random satellite access scheme that enables us to use low-cost ODU hardware and allows the VSAT network to handle momentary peak traffic loads without any significant degradation of response time. The Skystar Advantage VSAT now offers a feature enabling Internet connectivity, and an internal single voice channel capability, enabling voice communication between the hub site and a remote location. A VSAT network incorporating our Skystar Advantage VSAT product can offer features including: low-cost terminal equipment; rapid response time; high network availability; small antenna size which allows for easy installation and maintenance; very low transmission error rate; high hardware reliability; a variety of customer interfaces such as local area networks ("LAN") (e.g., Token-Ring and Ethernet); and flexible architecture (support for commonly used data communications protocols, including X.25, SNA/SDLC, ASYNC and TCP/IP; easy integration of additional value-added services such as data, audio and video broadcasting; and modular design that enables easy and staged network expansion).

New Product Under Development. A major value-enhancing asset acquired in the Spacenet acquisition is the technology developed by Spacenet as part of its planned new Turbosat product. We plan to utilize the Turbosat technology in a new product. The Turbosat technology, though not yet fully developed, is intended to increase throughput, expand product features to serve additional applications and reduce cost. The technology will also accommodate changes in customers' performance and application requirements through its ability to be upgraded to a satellite multimedia platform or a terrestrial router. Other distinguishing features are its advanced level capability for data, audio and video broadcasting.

One of the most important features of the acquired Turbosat technology is that it enables a wide range of flexibility through the application of spread spectrum and CDMA technologies as the satellite access method. The acquired technology includes a patent for the use of these features in two-way VSAT applications. These patented technologies can enable the production of a VSAT system capable of deploying transmit/receive remote antennas as small as 0.47 meter in diameter without overstepping FCC adjacent satellite interference regulations and of allowing inbound data rates up to 1.7 Mbps through the use of larger antennas. The potential integration of CDMA technology into our new VSAT platform remains one of the serious hurdles to successfully completing the full development of the Turbosat technology.

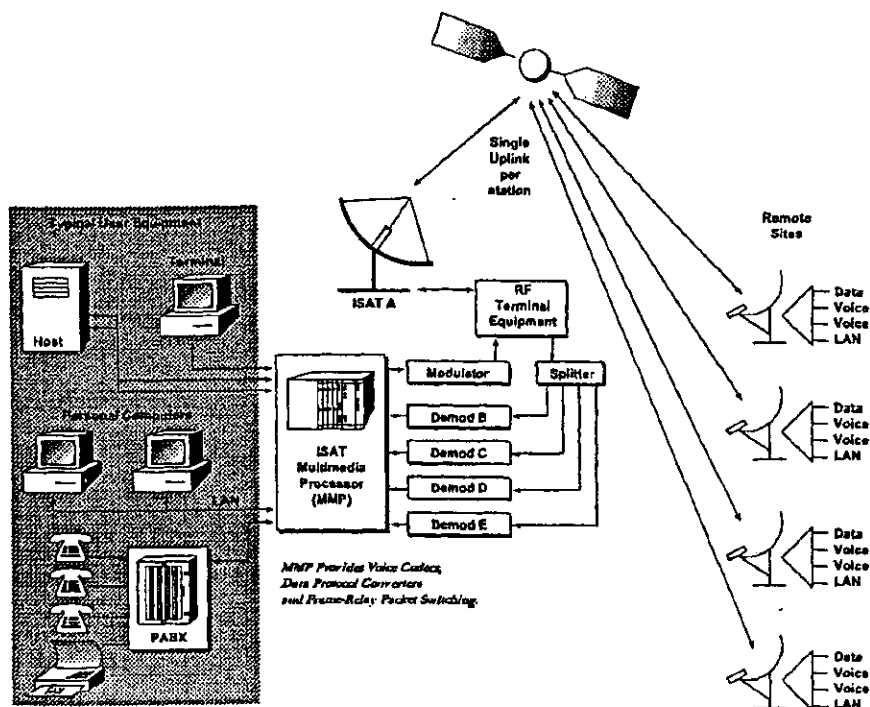
In addition, the use of innovative concatenated forward error correction coding techniques coupled with the use of other coding technology, the capacity for scalable network data rates and an innovative mechanism to reduce the size of satellite transmission units will enable the product to have other advantages. For example, unlike typical networks which jump in large steps (i.e., 256 kbps, 512 kbps or 1MB) and offer only a few choices for data rates, these technologies enable data rates to match users' needs more accurately. Consequently, satellite space segment capacity can be expanded in an incremental and cost-effective manner while the reduction in satellite transmission unit size provides for more efficient use of space segment capacity. Another important feature developed as part of the Turbosat technology is a significant software improvement which will replace the traditional Skystar Advantage software solution to hub-VSAT dialogue and enable relatively quick adaptation of customer protocols demands.

We believe that there is no VSAT system which is currently commercially available that has these capabilities and upon completion of their development our management believes the Turbosat technology will enable us in the future to offer the most technologically advanced VSAT in the market.

Prior to the acquisition, Spacenet had incurred approximately \$20 million in Turbosat development-related costs. We estimated that the Turbosat project was 70% complete at the time of the acquisition. Since the acquisition, the research and development of Turbosat technology has progressed, with most of Turbosat's improved functionality and features completed and the technology integrated (other than CDMA) into a new product platform, Skystar Advantage TG (Turbo Generation), which is being implemented for the USPS network. See "Customers - USPS Transaction." Management estimates that the remaining Turbosat technology development will be completed during the fourth quarter of 1999 excluding integration of the CDMA technology, for which we are directing research and development activities over the next 12 months. At the time of the acquisition, we estimated that the additional cost to complete the Turbosat technology would be \$6 million, which continues to be management's estimate. To the extent successfully completed, the new product incorporating the Turbosat feature set will be marketed by us under the Skystar Advantage trademark while maintaining backward compatibility. In developing our financial projections of future revenues and costs, we included the positive impact of the introduction of the new Skystar Advantage with Turbosat feature set on our future earnings estimates and our capability to expand in new markets, including the small home office market. We are reasonably confident in the successful completion of the development of the Turbosat technology. Should we be unable to complete development of certain aspects of the Turbosat technology, we could suffer a negative impact to our financial condition. See "Risk Factors—Risks associated with new product research and development in process at Spacenet", "Item 9: Management Discussion and Analysis of Financial Condition and Results of Operations - In-Process Research and Development".

Financial
forecasts

ISATTM. Our ISAT networking products are designed to provide high-end solutions for voice, fax and data communications for small-to-medium VSAT networks. ISAT uses a sophisticated frame relay switching engine and a patented satellite access technique to implement full or partial mesh or star topology networks. A mesh configuration allows "single hop" connection of subscribers' equipment by which remote terminals can communicate with one another without going through the hub. In a star configuration, remote terminals are connected only through the hub, with some delay in communication whenever two remote terminals communicate with each other. We offer ISAT networks to 2 types of customers. The first typically requires voice and data connectivity between 3 to 20 stations in a single-hop, full mesh network, usually to implement a private voice and LAN network between offices or factories to bypass often unreliable local phone service. The second type of customer requires similar services, but needs connectivity between 3 to 50 stations and a single hub location in a star or partial mesh type network.



Architecture. An ISAT network consists of several remote terminals and a PC-based NMS installed at one of the network terminals for network status and software control of data rates and other network parameters. The remote terminal consists of a small outdoor antenna (typically 1.2 to 3.8 meters), an RF transceiver for Ku-band and C-band reception and transmission, baseband equipment with a modulator and one or more demodulators, a control and routing unit incorporating a Multimedia Processor ("MMP") engine supporting voice, data, and LAN interfaces, and a Station Interface Unit to monitor and control interface between terminal equipment at each site and the master station network management software. ISAT systems use a "Frame Relay" protocol for transferring messages over the network. At each terminal, outgoing packets are statistically multiplexed into a single data stream by the MMP. The data stream is then converted into a single outbound modulated carrier and transmitted to the satellite for rebroadcast. Each ISAT carrier operates on a discrete, assigned satellite frequency.

In a full or partial mesh network, each terminal has demodulator equipment to receive carriers from each of the other network terminals with which direct communication is needed. The star equipment configuration is identical to the full mesh, except remote terminals require a demodulator only for the master terminal signal. The data rate transmitted over the satellite from each terminal is set to match the traffic requirements of the station. Standard ISAT equipment provides software-programmable rates over the range 9.6 kilobits per second to over 2 megabits per second. Different terminals within a network may have different rates to accommodate unique site traffic requirements.

Features. ISAT networks can be provided with a Demand Assigned Multiple Access ("DAMA") overlay, allowing occasional connectivity to be established as required between star-type remote stations, for voice networks with only occasional voice requirements between stations. ISAT terminals feature high hardware reliability; easy installation and maintenance; a variety of customer interfaces; and flexible architecture.

We have developed WebSat™ as an enhancement to ISAT, for Internet and Intranet connections. With WebSat, ISAT integrates an IP accelerator to overcome typical satellite speed limitations for IP data and manages data flow from multiple connections using Quality of Service bandwidth controls. Our current development efforts for the ISAT are directed towards cost reduction and replacement of outsourced components with devices that we have developed and produced.

As of December 31, 1998, we had shipped approximately 350 ISAT terminals to customers worldwide.

Unidirectional Data Broadcast (OneWay VSAT and Gilat Florida's Receiver). Gilat Florida's VSAT products as well as our original OneWay VSAT product are used in point-to-multipoint, satellite communication networks and are designed to provide reliable and cost-effective unidirectional data broadcasts from a central hub to a large number of geographically dispersed sites (from several dozen to several thousand). The networks may be configured to broadcast from one data feed in a "clear channel" configuration to numerous separate data feeds in a multiplexed configuration. We offer the multiplexed configuration for customers who need to aggregate multiple information feeds for distribution to numerous sites, such as information service providers.

The OneWay VSAT currently is being used at locations worldwide for applications including financial information distribution for stock exchange and other financial information service providers, newswire transmissions for news agencies and paging for network operators. Gilat Florida's VSAT networks are used worldwide for paging and newswire applications. We are now focusing on Gilat Florida's unidirectional product line and are discontinuing our original OneWay product, although we intend to continue to support existing customers.

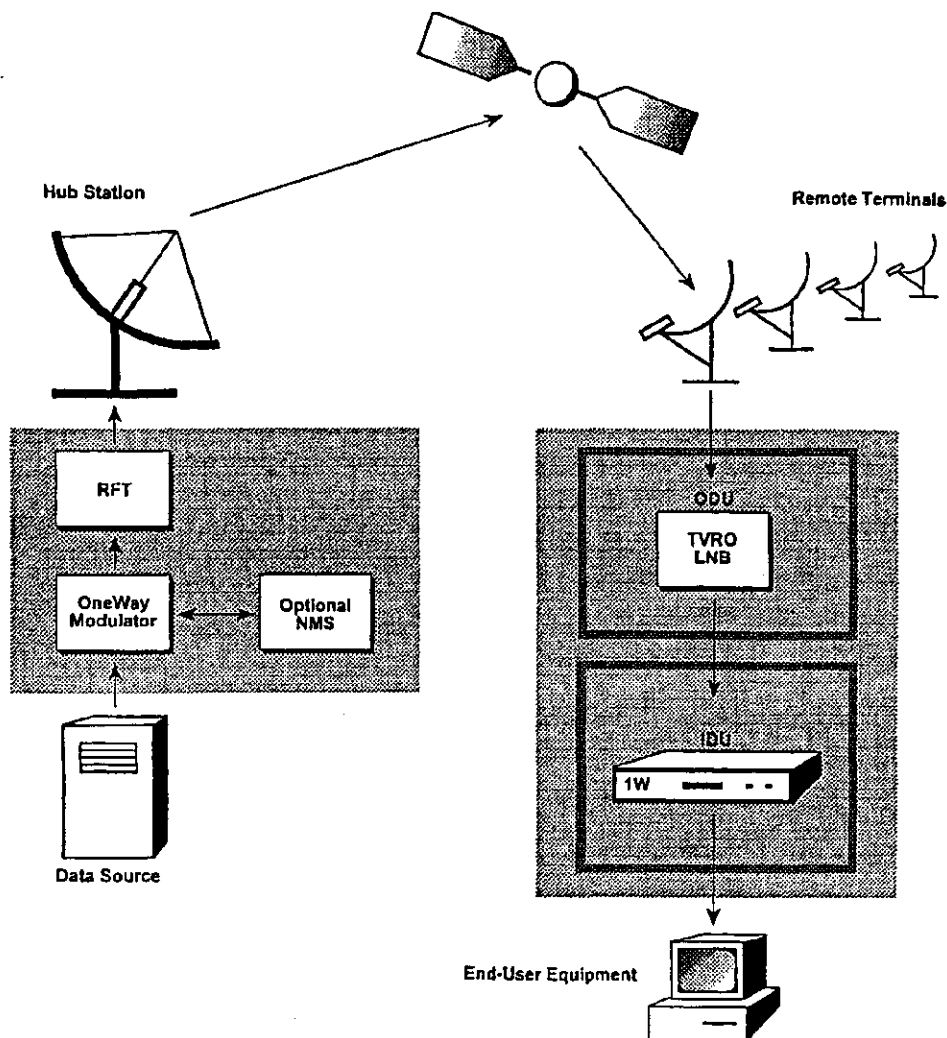
Gilat Florida's VSAT Architecture. The Gilat Florida line of broadcast receivers is focused on the unique needs of the paging and wireless community. A typical Gilat Florida paging network consists of a central hub facility and multiple receive-only remote stations. The hub generally uses a 3.7 meter antenna for C- or Ku-Band systems, redundant RF transceivers and power amplifiers, and redundant baseband modulation equipment. In some applications, business networking services are also provided through the central hub using ISAT equipment. A receive-only remote station consists of a small antenna, usually 1.0 m in Ku-Band or 1.8 m in C-Band, an LNB, cable and a Gilat Florida broadcast receiver. The data stream from the receiver is connected to a high powered paging transmitter, providing the final link to customer pagers. For multiplexed service, a multiplexer is added to the hub and a demultiplexer is added to each receiver.

Gilat Florida's VSAT Features. Gilat Florida receivers offer performance specifications that allow implementation of simulcast paging systems. The Gilat Florida receivers feature high stability; low jitter operation with high hardware reliability; operation at low link levels for customer service during severe weather conditions; wide data rate capability, offering data rates from 9.6 kilobits per second to 2 megabits per second; and the ability to vary the data rate or satellite frequency using commands loaded over the satellite from the hub, thereby allowing reconfiguration of the satellite system over time.

Our current development efforts for the Gilat Florida receivers are directed to improving performance, to adding new features such as upgrading to interactive capability and to continuing to reduce the cost of the product.

As of December 31, 1998, we had shipped approximately 19,250 of our Gilat Florida receivers to customers worldwide.

OneWay VSAT Architecture. A OneWay VSAT network consists of a central hub, a satellite and numerous receive-only remote terminals that can support either a clear channel or multiplexed configuration. Our OneWay remote terminal consists of a small standard television receive-only ("TVRO") antenna (typically 60 centimeters to 1.2 meters in diameter), an ODU and an IDU, which incorporates the OneWay VSAT receiver. The ODU consists of an LNB that receives transmission signals from a satellite transponder and down-converts the signals to the IDU. The IDU's principal functions are to demodulate and provide error correction to the incoming signal so that it can be used by the end-user's equipment. In the multiplexed configuration, the multiple information feeds are aggregated into a single satellite signal which is then transmitted through the satellite and separated at the remote terminal by our demultiplexer, embedded in the IDU. Our "PageReceiver" is equipped with a synchronous demultiplexer, which, when used with the multiplexer at the hub, offers a solution for large paging networks. We design and manufacture the OneWay transmitter, receiver and demultiplexer and integrate the other network components.



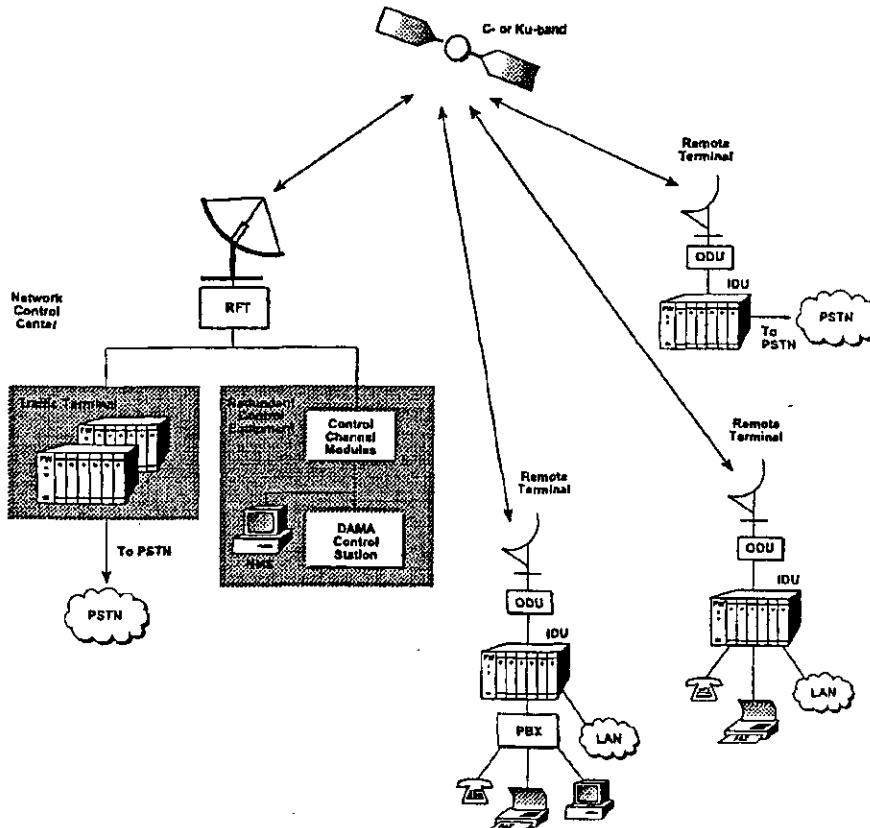
As of December 31, 1998, we had shipped approximately 20,650 of our OneWay VSAT terminals to customers worldwide, although we have discontinued this product line in favor of the Gilat Florida unidirectional VSAT product line.

Telephony and Voice Products:

FaraWay VSAT. Gilat and the predecessor of ParaGea Communications, COMSAT RSI, are parties to a joint venture for the development of the FaraWay VSAT, a satellite telephony VSAT which provides mesh connectivity, voice and data services via satellite to remote locations and other areas that lack adequate telecommunications infrastructure. FaraWay VSATs are intended to provide:

- A reliable telecommunications network (with fax and data capabilities) for corporate and business users in developing countries that have minimal or no telecommunications infrastructure

- Basic multi-channel toll quality telephone service to geographically isolated rural residential areas in developing countries
- Cost-effective telephone service that can be installed quickly for temporary remote installations (e.g., oil and gas exploration sites, small rural government agencies and new factories) until terrestrial services are available.



Architecture. The FaraWay telephony product employs a unique VSAT architecture and satellite access scheme and supports either a mesh or star configuration utilizing DAMA for more efficient use of the satellite. The product architecture permits connections to either private telephone equipment, pay telephones, small private switches or a public switch, and data terminals, as well as to any combination of this equipment. A Data Interface Module ("DIM") enables high data rate applications in both star and mesh configurations.

The remote terminal of the FaraWay includes a dish antenna (typically 1.8 to 3.7 meters in diameter), an ODU and an IDU. The IDU connects directly to subscribers' telephone equipment or central office. The FaraWay hub, which may be connected to a public switch, includes a large dish antenna (typically 4.6 to 13 meters in diameter), RF electronics, a network resource and call-processing controller, an NMS, a call accounting computer and traffic terminal. The network resource controller assigns satellite frequencies to the equipment at both ends of the communication link; the NMS monitors and controls the

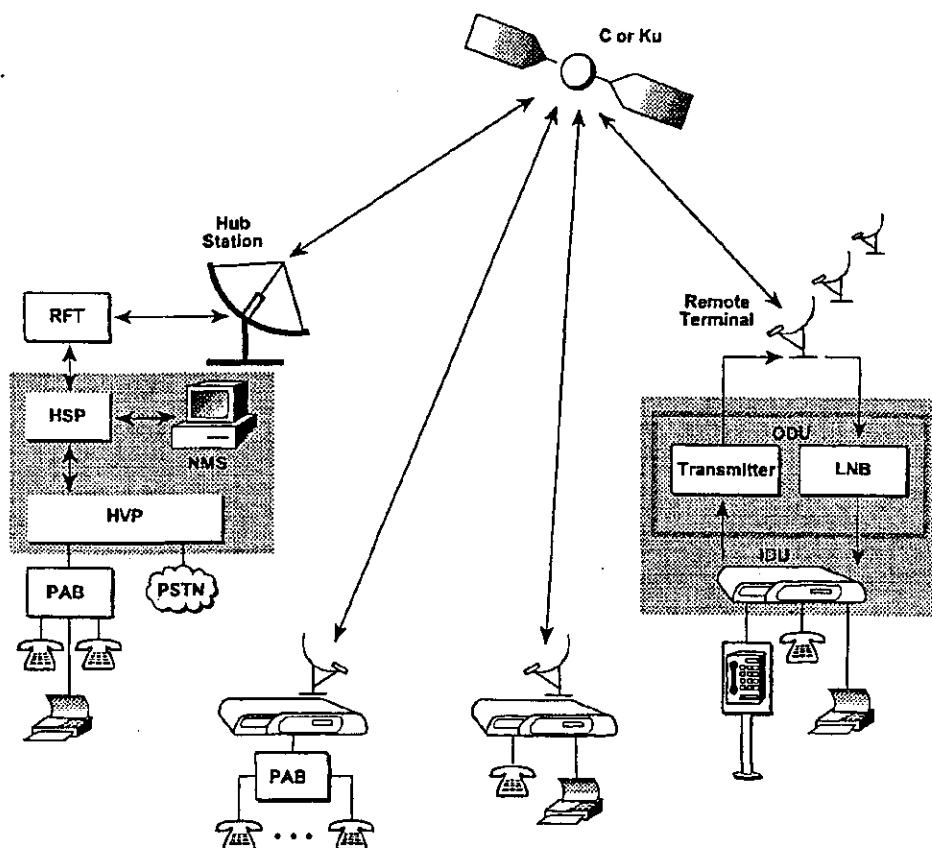
overall network; the call accounting computer provides data for external network billing; and the traffic terminal provides the hub's interface to the public switch.

Features. The FaraWay VSAT offers a cost-effective, flexible solution for connecting 2-40 telephone lines from a public switch to a local PABX switch or directly to subscribers' premises via satellite and to support voice, fax and high data rate applications. The product features include: Ku-band and C-band frequency operation; flexible interfaces including different signaling systems; support of up to 3,200 simultaneous telephone calls and 25,000 telephone circuits; and ITU-approved 16 and 8 kilobit per second voice encoding.

Our current development efforts for the FaraWay VSAT are directed towards development of a PC Network Terminal ("PC NT") -based NMS and additional FaraWay product features and enhancements.

As of December 31, 1998, we had shipped approximately 990 FaraWay VSATs to customers.

DialAway VSAT. Our DialAway VSAT product is intended to provide inexpensive, near toll quality dial tone telephone service for voice and fax communication for small businesses and villages in remote or urban areas lacking an adequate telephone infrastructure. The product has been designed to offer subscriber or pay telephone public call offices and up to 3 lines. Our rural telephony product operates in a star configuration in which the remote terminals communicate with one or several hub sites. The product operates with a single tier architecture in which all network users receive the same grade of service and limited fax capability. We believe that the cost benefits of the new product with the star configuration will meet the more limited service needs of the targeted rural telephony users, who to date generally have been without any service.



Architecture. A DialAway network consists of a central hub, satellite channels and remote terminals. A remote terminal consists of a small outdoor antenna (typically 0.98 to 1.2 meters), an ODU and our IDU with one to three telephony extension cards. The hub consists of an RFT and baseband equipment. The RFT incorporates a large dish antenna (typically 4.5 to 11 meters) and RF electronics equipment (up and down frequency converters, low noise amplifiers and high power amplifiers). The baseband includes an HSP, a Hub Voice Processor ("HVP") with voice cards, and an NMS. The NMS monitors and controls all the remote terminals and the hub equipment. The hub design permits easy incorporation of new features, as well as independent sizing for inbound (remote to hub) and outbound (hub to remote) bandwidths.

With the DialAway, the analog voice input is digitized and compressed to 4.8 or 6.4 kilobits per second. The compressed voice is organized into packets and transmitted to the hub or to another remote VSAT via the satellite. At the destination, a voice/fax card decodes the incoming voice packets into digitized voice which is then reconverted into analog form.

Features. Our DialAway VSAT product offers such features as full support of telephone line services; call data processing; low cost; simple installation and operation; high hardware reliability; remote control and monitoring; and low power consumption. In 1998, we completed the development of a PC NT-based NMS.

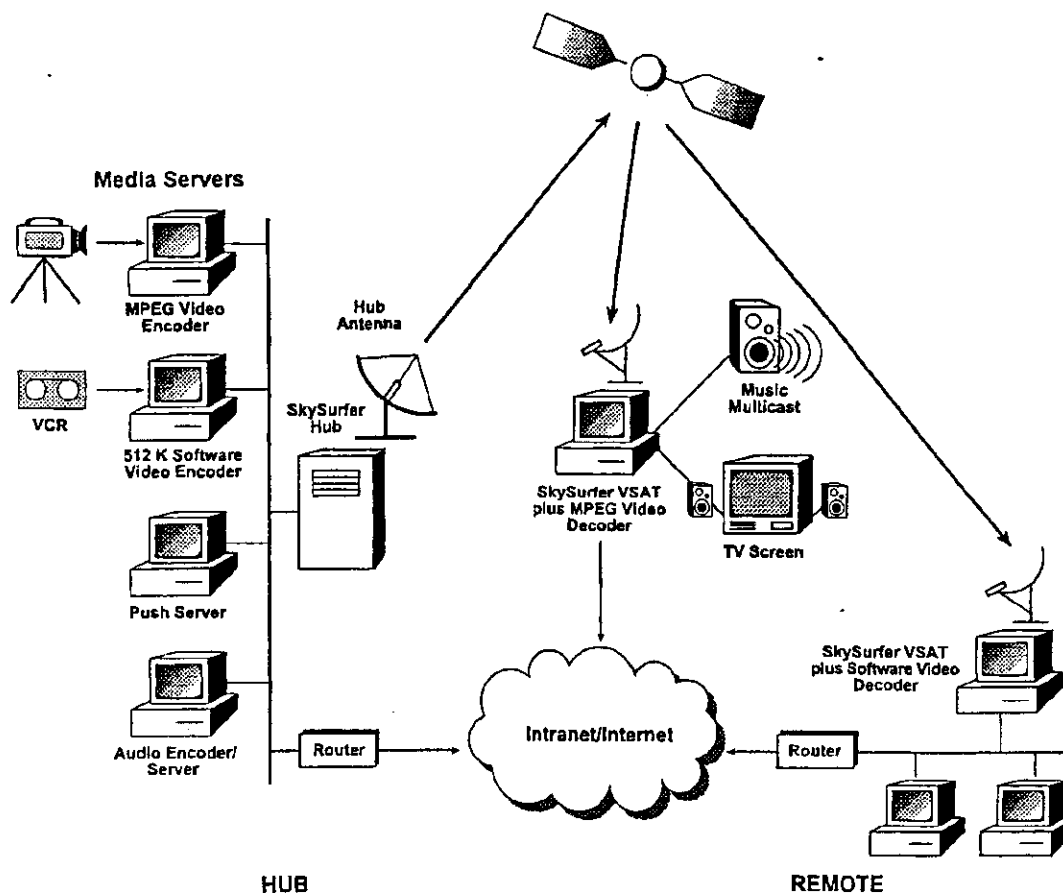
Our current development efforts for the DialAway are directed towards development of certain product features, including multi-star gateways to enable multiple PSTN interconnections, mesh configuration, enhanced NMS and improved functionality. We expect to continue the development of such features, enhance the product capabilities and reduce costs per line and per minute over the next 12 months, although the development efforts may not be completed within the current schedule or with the features anticipated.

As of December 31, 1998, we had shipped approximately 5,100 DialAway VSATs.

IP-Based Products:

SkySurfer VSAT. Our SkySurfer VSAT receiver product is a PC-based Digital Video Broadcast ("DVB") satellite receiver used in IP environments to provide satellite-based multicast and unicast communications. The SkySurfer is designed to stream IP traffic from a central site to a large number of geographically dispersed remote sites. It is an open IP platform that enables easy integration of any IP-based application. SkySurfer can be deployed as an overlay to existing networks or as new infrastructure for end-to-end enterprise solutions. The main applications running on SkySurfer networks are web-based interactive corporate training and distance learning, interactive business television, multicast video and audio streaming, broadband Intranet/Internet access and reliable push based applications.

The SkySurfer remote unit receives high bit-rate traffic via satellite (from 2 to 40 Mbps) and currently utilizes the user's return path (terrestrial or VSAT) for transmission. The SkySurfer hub provides users with a scalable 2-40 Mbps channel for IP traffic.



Architecture. The SkySurfer VSAT consists of a central transmission hub and the remote SkySurfer receiver cards. The central hub consists of several Hub Transmission Servers ("HTS") which receive the content from the server at the central site or anywhere over the Internet. Each HTS is a PC server running applications that we developed. The HTS transmits the data to the satellite modulator which converts the data to the intermediate frequency ("IF") range. The output of the modulator is transmitted to the satellite by standard RF transmission equipment. Our NMS, situated at the transmission site, controls the parameters of the hub and remote SkySurfer units.

The remote SkySurfer VSAT consists of (i) a 32-bit PCI adapter card that fits in any standard PC and enables receipt of high-speed data (up to 40 Mbps) by a PC or LAN server, (ii) a small outdoor antenna and (iii) an LNB. A return path can be established over any existing terrestrial or two-way VSAT connection.

Current research and development efforts on the SkySurfer are intended to improve its functionality as well as the NMS capabilities, increase throughput and effective data bit rates and reduce costs.

As of December 31, 1998, approximately 10,750 of our SkySurfer VSATs had been shipped to customers worldwide.

Features. For interactive business television and corporate communications, we offer IP-based multicast and Intranet technologies that provide interactive business television with Movie Picture Expert Group ("MPEG") decoding quality. We provide a turnkey solution, beginning with the customer's video source, continuing with the video encoding server (including the IP multicast data layer) and ending with the video decoder card.

For corporate training, using third party proprietary training technology, SkySurfer enables full broadband software video decoding with multicast capabilities for on-line training to hundreds of employee LANs and PCs simultaneously.

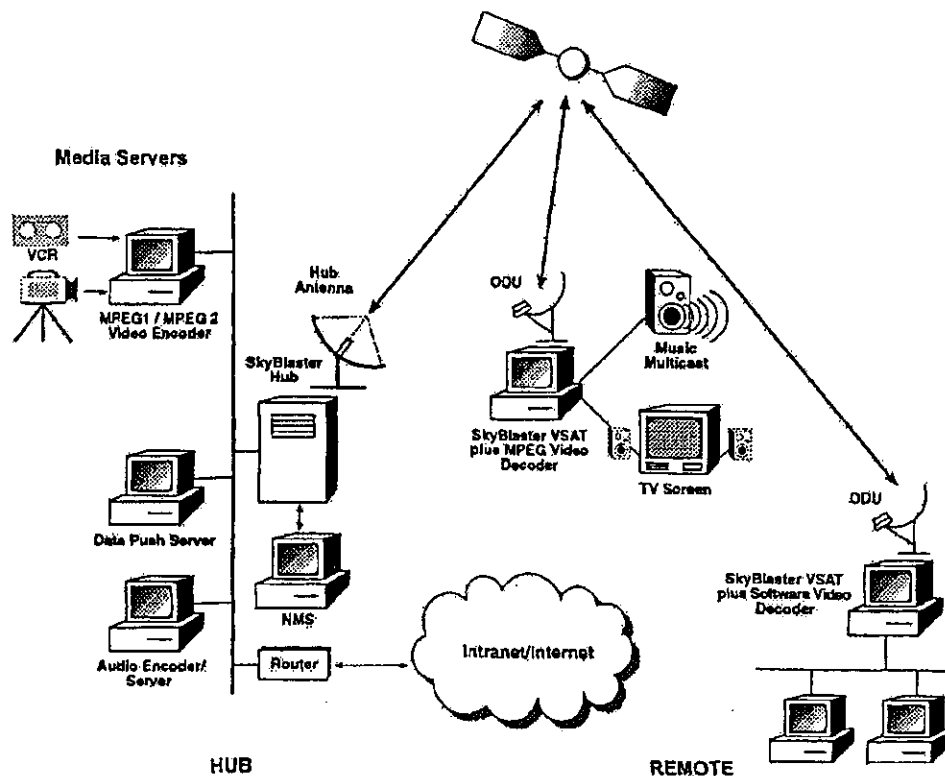
For push-based applications, SkySurfer, which we bundle with third party technology, offers an integrated end-to-end push client server solution, optimized for satellite delivery and IP multicast. This integrated solution allows companies to deliver corporate information and software from a variety of sources and to notify employees and management of its availability.

For broadband Intranet/Internet access, SkySurfer—using Gilat's IP spoofing technology—enables data rates of more than 1 Mbps, while accessing corporate Web servers or Internet sites. LAN users can also access the global Internet through the SkySurfer gateway, without installing SkySurfer at their PCs.

SkyBlaster VSAT. The SkyBlaster VSAT, introduced in January 1999, is our latest two-way IP-based product and consists of a DVB receiver card and a satellite transmitter PCI card as a return channel.

With our unique satellite return access scheme PC users will have access to fully interactive broadband VSATs on corporate LAN servers or PC desktops. SkyBlaster provides IP-based communications solutions for broadband corporate and public networks.

SkyBlaster features an open IP platform which supports applications developed by us or by third party vendors such as interactive corporate training; reliable data and video multicasting; interactive business television and reliable push-based applications.



Architecture. SkyBlaster VSAT combines two PCI cards:

- DVB receiver
- Satellite transmitter

The DVB receiver card supports a scalable bit rate of 2 to 40 Mbps. Inbound data can be transmitted at bit rates of 38.4 to 153.6 Kbps, using a unique Frequency Time Division Multiple Access ("FTDMA") satellite access scheme. The cards can be installed in any standard PC server, supporting data recasting over the LAN, or be provided as a stand-alone IDU. Research and development efforts are focused on increasing the bit rates to 76.8 to 307.2 Kbps by the end of 1999.

The hub station was designed for installation at the customer premises as a private hub. Alternately, a shared hub can be located at a service provider site. Single-tier architecture allows for PC connectivity directly to the application and media servers. As shown in the diagram, any media server connected to the hub, such as a video, audio or data push server, is allocated with a reserved committed bit-rate that guarantees high-speed accessibility. Therefore, multiple streams carrying video, audio and data can operate at the same time without interfering with one another. The hub station features:

- NMS (Network Management System)
- HTS (Hub Transmission Server)

- DVB IPE (IP Encapsulator)
- DVB Satellite Modulator
- HSP (Hub Satellite Processor)
- Conditional Access (security)
- Scheduling

Satellite Access. SkyBlaster uses a proprietary two-dimensional access scheme. This enables the use of low-cost ODU hardware, minimizes space segment use and allows the VSAT network to handle momentary peak traffic loads without significant degradation in response time. The network is immune to outages caused by frequency interference.

The unique FDMA scheme provides no back off in time for retransmissions and consistent utilization of the entire bandwidth by all remote sites. The satellite access scheme, coupled with a transmit slot size that can be optimized to the network, provides superior network throughput stability and load balancing.

VSAT Network Services.

In our two primary geographic markets, the United States and Europe, we now provide full network services through our network management centers, in addition to product sales. We offer a full spectrum of services, from installation and maintenance services to comprehensive service offerings in which we package the VSAT system with installation, network operations, maintenance and access to satellite transponder capacity. Our services include:

- Network Analysis
- Network Implementation
- Shared Hub Services
- Network Operations
- Maintenance
- Customer Technical Services
- Access to Satellite Capacity

In addition, we also provide network services in Argentina and support for network services in India.

Network Analysis. Network analysis involves designing the system in response to specific customer needs, determining critical system parameters, such as data protocols and network response times, assisting in generating component and subsystem specifications for the network's hardware, hub requirements (private or shared), and satellite capacity.

Network Implementation. The network implementation process covers hub installation and network rollout, which entails installing and connecting all of the remote VSAT locations to the network. Network rollouts are planned and managed by the Gilat program management organization. The program manager serves as the customer's single point of contact and is responsible for delivering the network on time, on budget, and to specification.

Many of the activities for installing a VSAT network take place at the customer's facilities, such as: site survey, site preparation and installation of ground, wall, and/or wall-supported mounts with lightning protection, connection of the ODU and IDU to antenna and Inter Facility Link ("IFL") cable, powering up the system, pointing the antenna, initializing the VSAT and confirming proper operation with the hub, connecting the VSAT with the customer's local equipment (such as LAN or POS), and providing an orientation to the local customer personnel. A typical installation can be completed in four to six hours. We are increasing our installation capabilities and currently can install 3,000 sites per month in the US.

Hub installation services vary, depending on whether the customer network involves a private hub or use of one of our shared hub facilities in Chicago, Atlanta, Germany and the Czech Republic as well as Argentina. The primary distinction between the two is that private hub installation involves more emphasis on site preparation, equipment installation and training, while shared hub installation focuses on the compatibility with the shared hub and host architecture.

We currently use in-house personnel for hub installation and third parties to perform most VSAT installation activity in our service markets. The program manager, working with our in-house

implementation staff, insures that our third-party installation teams arrive at the customer's site on schedule and are equipped with the necessary equipment to complete the installation. The third-party installers are trained and certified on the Gilat hardware platforms.

Shared Hub Services. The hub is the most costly and complex component of a VSAT system. Some customers prefer to outsource the management and operation of the hub, either by leveraging our competency in managing networks or by gaining additional cost efficiencies through sharing the hub hardware and operations costs with multiple customers. Gilat presently staffs its primary shared hubs in the U.S., Germany and Argentina, with a highly specialized technical staff on a 24-hour basis. Our shared hub service typically includes use of hardware, maintenance, ground-based backhaul circuits, and operations for which the customer pays a monthly fee.

Network Operations. Our network operations services coordinate and manage the operations of customers' networks and monitor the quality of services delivered on a 24-hour basis from one of our three network management centers (NMC). Our largest NMC is located in McLean, Virginia, and is staffed by over 40 technicians who are trained in network fault isolation, problem resolution and customer service. We also have NMCs in Germany and Argentina. When customers experience an outage on their network, they call the NMC, where a trained professional, using proprietary monitoring and control technology, will work to restore service. In instances in which service cannot be restored through the troubleshooting process, the NMC technician will dispatch one of our third-party field service technicians to repair or replace the on-site hardware and restore operations to the site.

In 1998, Gilat NMCs managed approximately 27,500 data and video sites in the United States and nearly 34,000 sites worldwide.

Maintenance. Once an NMC technician determines that a field service dispatch is required to fix a problem, our maintenance and logistics organizations provide service to the customer. We offer a variety of maintenance plans to support our customer networks. All of the plans include toll-free trouble reporting service from one of our NMCs, field service, replacement of equipment, warehousing of spare parts, shipping and repairs. The objective is to provide an on-site response within an average of four hours for most sites. In the United States, we have contracted with IBM-TSS, a third-party repair service provider, to operate nationwide service centers that are staffed with Gilat-trained and certified field service technicians. Other trained and certified third-party vendors are contracted in our international service markets.

Our maintenance services are supported by our internal logistics and repair organization, which is responsible for stocking parts in over 100 warehouses in the U.S., Europe and Argentina.

Customer Technical Services. Our technical services group includes engineering test and support services during the project implementation phase and on-going telephone and on-site support for complex networking issues. The customer technical services group provides application trouble shooting, network optimization, customer training, and documentation services.

Protocols and Methodologies. The development of new software protocols and methodologies has resulted in improved use of available network capacity and decreased delays in transmission of information. Our networks support multiple protocols simultaneously, including SDLC, Bisync, X.25, X.3/X.28/X.29 PAD, Token Ring LLC, Ethernet LLC, and TCP/IP. The performance of these protocols across satellite bandwidth is optimized by techniques such as TCP/IP "spoofing," which improves data throughput efficiency. In addition, our VSAT networks have built-in protocol conversion capabilities, including X.25 to Async PAD, SDLC to Token Ring, Bisync to Token Ring, and TCP/IP over Ethernet to TCP/IP over Token Ring, which allow our VSAT networks to operate with multiple protocols without the purchase of additional equipment. Our networks also support various methodologies, including frame relay, ATM and various others.

Satellite Capacity. Satellite transmission channels are an integral part of our VSAT network offers in the U.S., Europe and Argentina. We continually monitor our space segment capacity, all of which we procure from third parties, in order to ensure that sufficient transmission capacity is available for prospective customers, as well as growth in bandwidth for existing networks. The capacity is provided for the term of the agreement, typically five years, and may be increased under the term as the customer's traffic grows. For networks in the United States, we use satellite capacity acquired from GE Americom, which currently operates a fleet of 12 satellites, as well as from other suppliers. In connection with the Spacenet acquisition, we entered into a series of agreements with GE Americom under which GE Americom will provide us with backup and additional satellite services. These agreements are described below under the heading "Certain Relationships and Related Party Transactions—The Satellite Transponder Service Agreements." We also use capacity on several regional satellites in Europe and Argentina.

We believe that there is a large and growing quantity of satellite capacity available from a number of providers in the United States and in the rest of the world from whom we can obtain transmitter capacity at competitive rates, as our business requires.

Service Offerings. Service offerings combine a rental of all necessary network hardware with all of the above network services into an end-to-end customer solution. In a service offering, we retain ownership and operation of the network, delivering to the customer a specified network speed, response time and network availability for a set price per month per site. Generally, service offerings contracts have a five-year maturity. However, we intend to propose three-year contracts to respond to market demand.

Service offerings respond to our customers' needs to outsource non-core competencies and mitigate technical obsolescence and make the purchase of satellite network services similar to the procurement of ground-based network services.

To date, our service offerings have been based on the Skystar Advantage two-way data platform. However, we are leveraging our existing network services infrastructure to add new service offerings that include the SkySurfer and SkyBlaster product lines in the second half of 1999.

Marketing, Distribution and Strategic Alliances

Marketing and Distribution. We use both direct and indirect sales channels to market our products and services. Our marketing activities are organized geographically, with groups covering North America, Europe, Latin America, Asia and the rest of the world. In North America and Europe, most of our revenues are generated by our direct sales force, although value-added resellers and distributors account for some of our largest networks. In Asia and the rest of the world, we rely primarily on local agents and distributors. In all markets, we occasionally work with system integration companies for large and complex projects.

The sales teams are comprised of account managers and sales engineers, who are the primary account interfaces and work to establish account relationships and determine technical and business requirements for the network. These teams also support the other distribution channels with advanced technical capabilities and application experience. Sales cycles in the VSAT network market are lengthy and it is not unusual for a sale to require 18 months from initial lead through signature of the contract. The sales process includes several network design iterations, network demonstrations, pilot networks comprised of a few sites, and in some cases special software development which is completed before contract signing. For VSAT networks sold as a complete service offering, the sale cycle is typically shorter and can be as low as 90 days from the initial lead through the signature of the contract.

We have a sales and marketing group of 141 full-time employees (as of May 1, 1999) who offer our products and services, primarily in the United States and Europe. Approximately 48% of the sales and marketing group is based in the United States and approximately 18% is based in Europe. Sales of our services generally are substantial in size and involve a long-term complex sales process.

We currently have marketing and technical support staff in the United States, Europe and Israel. In addition, we maintain marketing and support offices in Argentina, Hong Kong, Brazil and Australia which provide ongoing marketing and technical support of our products for our strategic partners and their customers. These offices also work with our strategic partners to identify target markets and applications and define products to meet those needs. In addition, we have established a liaison office in India and representative offices in Thailand and Beijing to support our marketing efforts and support and coordinate local marketing offices in Central and South America and the Far East.

We also sell our products and services to postal, telephone and telegraph organizations ("PTTs") and other major carriers, resellers and other companies in the United States and internationally who purchase network products and services from us for resale to their customers. PTTs and other major carriers employ substantial sales forces and have the advantage of being existing providers to many of our target customers, which makes marketing easier and increases awareness of customer needs.

The following table sets forth Gilat's sales by geographic area for the periods indicated below as a percent of Gilat's total sales:

	Years Ended December 31,		
	1996	1997	1998
United States ¹	50.0%	49.5%	51.8%
Europe	7.6%	8.9%	6.7%
South and Latin America ²	6.8%	11.1%	6.9%
China	16.7%	4.6%	3.5%
Israel ³	3.8%	3.3%	2.7%
South Africa	0.0%	0.1%	13.4%
Other	15.1%	22.5%	15.0%
Total	100.0%	100.0%	100.0%

¹ Includes sales of 7.2%, 11.6% and 2.8% made through GTECH and Spacenet in the United States with shipments made directly to end-users in Europe (including regional service operators and distributors) for the years ended December 31, 1996, 1997 and 1998, respectively. See Note 15 of Notes to Consolidated Financial Statements listed in Item 19.

² Including sales made to a subsidiary of GTECH in Brazil of 1.4%, 6.8% and 1.1% for the years ended December 31, 1996, 1997 and 1998, respectively. See Note 15 of Notes to Consolidated Financial Statements listed in Item 19.

³ Includes sales to related parties of 13.2%, 3.6% and 8.2% for the years ended December 31, 1996, 1997 and 1998, respectively. See Note 15 of Notes to Consolidated Financial Statements listed in Item 19.

Strategic Alliances and Joint Ventures. In addition to our direct and indirect sales channels, we have established certain key strategic marketing relationships and joint ventures, including the following:

GTECH. Since 1990, we have worked closely with GTECH Corporation ("GTECH") to develop GTECH's GSAT service offering which is used for computerized on-line state and national lottery applications. GTECH is a leading operator and supplier of computerized on-line lottery systems. GTECH's lottery system consists of numerous remote lottery terminals located in retail outlets, central computer systems and game software, as well as communications equipment that connects the terminals and the central computer systems.

In December 1994, we executed a seven-year agreement with GTECH (replacing an agreement executed by the parties in March 1993) pursuant to which we agreed to sell our VSAT product components to GTECH at agreed-upon prices and granted GTECH certain non-exclusive marketing and manufacturing rights to our interactive transaction-oriented VSAT technology for worldwide gaming applications (except in France), including, among others, lotteries, sports betting, pari-mutuel betting and horse and other race betting. Under our agreement with GTECH, GTECH was required to purchase from us or manufacture, directly or indirectly through a subcontractor, specified quantities of IDUs (which are part of the remote terminal) through 1996, which quantities have been substantially satisfied. Purchases by GTECH of the indoor units (IDUs) from us are at the price specified in the agreement, and for IDUs manufactured by GTECH directly or through a subcontractor, GTECH is required to acquire the necessary software from us and to pay us a royalty in respect of each IDU produced.

The GTECH agreement also provides that until February 3, 2001, we will not, directly or indirectly, sell our two-way VSAT technology for gaming applications or supply services similar to those provided to GTECH under the agreement to any person directly or indirectly in competition with GTECH in the gaming business. However, we may sell our TwoWay VSAT (i) through Spacenet for resale to persons or entities involved in the gaming industry, and (ii) to value-added resellers who may sell the TwoWay VSAT for gaming applications.

Under a memorandum of understanding signed in March 1996, GTECH agreed to purchase or manufacture 1,500, 2,000, and 3,000 IDUs, respectively, in the three years of the agreement after 1996. Although the parties have conducted business pursuant to the memorandum of understanding, a restated agreement incorporating the terms of the memorandum of understanding is to be formalized subject to the approval of both companies. Those approvals may not be obtained, or the final agreement may contain terms different from those contained in the memorandum of understanding or the existing agreement.

ParaGea. In late 1992, we entered into a joint venture with COMSAT RSI, Inc. (the successor of which is ParaGea Communications) to develop, manufacture and market two-way rural telephone VSAT products. In March 1997, the parties modified the agreement to apply only to the VSAT-based telephony product which had been jointly developed and marketed by COMSAT RSI under the trade name "TerraSat 400" and by Gilat under the name "FaraWay VSAT"; to restructure the product development plans; and to grant each party non-exclusive marketing rights worldwide. In November 1997, a further amendment gave Gilat sole responsibility for development of the FaraWay product for a period of one year, after which both parties have the right to develop the product.

KSAT. In January 1998, we entered into an investment agreement with KSAT, a Yukon company listed on the Vancouver Stock Exchange, and Global Space Investments Limited, a partially owned subsidiary of Keppel Telecommunications & Transportation Ltd., a Singapore public company involved in telecommunications activities. Under the agreement, among other things, Global invested \$15 million in KSAT and we converted to equity certain convertible instruments we held in KSAT. We also agreed to exchange our direct interests in certain joint ventures in China for shares of KSAT, subject to Chinese government regulatory approvals. Those approvals have been obtained and we are in the process of completing the share exchange. In light of the 1998 KSAT financing and upon the transfer of our joint venture interests, we will hold approximately 39.0% of KSAT (or 30.8% on a fully diluted basis). Two of our officers have been appointed to the Board of Directors of KSAT.

Global Village Telecom N.V. ("GVT"). We initiated our rural telephony project in 1997 through our then wholly owned subsidiary, Global Village Telecom N.V. ("GVT"). GVT was established to design, deploy, manage and operate, alone or with local partners, rural telephony communications networks to provide fixed-site, basic telephony service to rural and remote markets in developing countries, as well as other markets for public telephony service. We currently market our DialAway VSAT product, and other voice products, through GVT and GVT's local partners. As of December 31, 1998, GVT had placed orders for approximately 1,000 DialAway VSATs and one hub for a rural telephony network in Chile where GVT won a concession to provide service to approximately 1,727 remote villages. GVT has also won a concession for the first phase, involving 213 sites, of a rural telephony system in Peru and has provided 93 DialAway VSATs and one hub for this network.

In April 1998, GVT completed a \$40 million private placement with an international group of investors, as a result of which our interest in GVT was reduced to approximately 5.7%. We invested \$2.5 million in GVT as part of the private placement. We also provided a \$7.5 million loan convertible into common shares equal to approximately 15% of GVT. Depending on several factors and the occurrence of certain events, we may further increase our holdings upon exercise of warrants to acquire additional common shares at par value, to a maximum holding in GVT of approximately 40%.

We have agreed, among other things, to supply GVT with its ongoing equipment needs, and with necessary approvals from the office of the Chief Scientist, to grant GVT certain co-ownership rights in the DialAway technology, pricing rights and manufacturing rights, as well as certain exclusive marketing rights with respect to the DialAway product. We cannot assure that GVT will locate suitable investment opportunities or partners, local operators or joint venture participants, that GVT will be profitable or that significant sales of our products will result.

Customers

Customers. The majority of the customers for our products and services are large retail and consumer-oriented businesses, including retail and consumer distribution, convenience stores, restaurants and hospitality, gas stations, hotel, brokerage, banking and financial services, communications, lottery, automotive and government. We sell our products directly to these customers or indirectly through resellers. In general, networks for these customers range from approximately 100 to 4,000 sites, although some customers have satellite data networks considerably smaller and others considerably larger than this range.

The Rite Aid drugstore chain uses its VSAT network to reduce network response time for credit card transactions, to process prescriptions through its pharmacy system, to broadcast customized music and promotional programming to its stores on its private radio frequency and to send frequent corporate communications and sales training updates to employees on its own business television system. Automaker Peugeot-Citroën of France uses its network for interactive data applications such as inventory updates, credit authorizations, and warranty documentation.

USPS Transaction. During 1998, we were selected as subcontractor, under a prime contract awarded to MCI Corporation, for the provision of VSAT services to the United States Postal Service. Although the contract does not require the USPS to purchase specific quantities at specific dates, the USPS program is expected to initially link 10,000 small associated office locations throughout the United States, with potential growth to 26,000 sites during the ten-year program—nearly three times the size of today's largest VSAT network. Our VSAT services will provide the USPS with a comprehensive upgrade to existing terrestrial dial-up services now in use at post offices across the United States. The new VSAT network—which utilizes commercial off-the-shelf technology—will provide post offices with full-time, on-line networking capabilities on an unprecedented scale. The network will support a wide range of applications, including point-of-sale and credit card processing, package delivery confirmation, remote

monitoring, software and data file downloading, IP multicasting, and multimedia broadcast. The network will provide the USPS with world-class connectivity to all locations, enabling a superior, state-of-the-art customer service infrastructure. The VSAT network will provide on-line services to as many as 26,000 locations. An additional 7,000 sites are being installed as back-up services to the existing MCI WorldCom Frame Relay network at large associated office locations. The USPS contract requires certain product functionality involving Turbosat technology purchased as part of the Spacenet acquisition as well as additional research and development. We have begun roll out of the first phase of the USPS network, with installation of approximately 2,500 sites by the end of June 1999, and have scheduled further installations at the rate of approximately 1,000 sites per month, although we cannot assure that we will be able to meet that schedule. Should we be unable to complete development of product functionality features required under the USPS contract or meet the roll out schedule under the contract, we could suffer a materially negative impact to our financial condition.

Competition

The data communications industry is highly competitive and the level of competition is increasing. As a provider of data network products and services in the United States and internationally, we compete with a large number of telecommunications service providers. Many of these competitors have significant competitive advantages, including long-standing customer relationships, close ties with regulatory and local authorities, and control over connections to local telephone networks. This increasingly competitive environment has put pressure on prices and margins. To compete effectively, we emphasize the price competitiveness of our products as compared to products offered by ground-based and other satellite service providers, the advantages of satellite data networks in general, our network quality, our customization capability, our offering of networks as a turnkey service rather than as an equipment sale and our provision of a single point of contact for products and services.

We have encountered strong competition from major established carriers such as AT&T, MCI WorldCom, Sprint, British Telecom, France Telecom, Deutsche Telekom and global consortia of PTTs and other major carriers, which provide international telephone, private line and private network services using their national telephone networks and those of other carriers. Such carriers also offer technological solutions for customer networks, including ISDN lines and frame relay networks. Fiber optic cable is increasingly available for wide bandwidth networks in the United States and Western Europe, and competitive issues often involve tradeoffs among price, various features and customer needs for specialized services or technologies. We are facing increasing competition from ground-based telecommunications service providers which use frame relay, fiber optic networks and digital network switching to provide competitive network offerings.

Our VSAT networks generally have an advantage over terrestrial networks where the network must reach many locations over large distances, where the customer has a "last mile" or congestion problem that cannot be solved easily with terrestrial facilities and where there is a need for transmission to remote locations or emerging markets, as discussed more fully above. By comparison, ground-based facilities (e.g., fiber optic cables) often have an advantage for carrying large amounts of bulk traffic between a small number of fixed locations. However, the customer's particular circumstances, the pricing offered by suppliers and the effectiveness of the marketing efforts of the competing suppliers also play a key role in this competitive environment.

The major telecom carriers also serve as resellers of our products and services, and are an increasingly important distribution channel in Asia and Latin America. See "Marketing and Distribution"

Our principal competitor in the supply of satellite networks is Hughes Network Systems, which offers a full line of VSAT products and services and which obtains satellite capacity on the satellite system operated by its affiliates Hughes Galaxy and PanAmSat. In competing with Hughes Network Systems, we

emphasize particular technological features of our products and services, our ability to customize networks and perform desired development work, the quality of our customer service and our willingness to be flexible in structuring arrangements for the customer. In addition, we face competition from other satellite network providers, including Loral and its affiliates (such as Orion Network Systems) and, in certain instances, direct broadcast satellite companies.

We may experience increased competition in the future from these or other competitors that may adversely affect our ability to continue to market our products and services successfully. We believe that we have been able to compete successfully with larger telecommunications companies in part by entering into strategic joint development and marketing relationships with major companies such as GTECH and COMSAT RSI, by developing new products such as SkySurfer and SkyBlaster, and by emphasizing low-cost product and service features and functions that meet the needs of customers in the markets in which we compete. We are able to provide these product and service features and functions in part by using our proprietary hardware and software. See "—Patents and Intellectual Property."

We believe that our major competitors have the resources available to develop products with features and functions competitive with or superior to those offered by us. In addition, the entry of new companies into the market or the expansion by existing competitors of their product lines could have an adverse effect on us. However, we believe that our primary competitive advantage is our ability to provide products with relatively low overall cost and high functionality. We also compete on the basis of the performance characteristics of our products and our ability to customize certain network functions. We cannot assure that our competitors will not develop such features or functions, that we will be able to maintain a cost advantage for these products or that new companies will not enter these markets.

We also compete with other companies that offer communications networks and services based on other technologies (e.g., ground-based lines and frame relay, radio transmissions, point-to-point microwave) that can be competitive in terms of price and performance with our products. For example, there is a competing technology for a unidirectional VSAT system that uses a lower-cost remote terminal but requires more satellite space segments capacity than our unidirectional VSAT products. See "Risk Factors—Competition in the network communications industry."

Research and Development

Product Development. We devote significant resources to research and development projects designed to enhance our VSAT products, to expand the applications for which they can be used and to develop new products. As of December 31, 1998, approximately 24% of our employees in Israel and 16% of our employees in the United States were employed in research and development activities. Annual gross research and development expenditures were approximately 10.2%, 10.2% and 11.0% of sales in the years ended December 31, 1998, 1997 and 1996, respectively. Approximately 19.2%, 23.5% and 23.5% of our research and development expenditures for the years ended December 31, 1998, 1997 and 1996, respectively, were funded by the Office of the Chief Scientist, including funds received through the research consortia (as described below). Our initial research and development was funded by BIRD, but currently none of our research and development expenditures is funded by BIRD. We cannot assume that funding at any level will continue to be available or that funding will be available on attractive terms.

We intend to continue to devote research and development resources to complete development of certain features, to improve functionality, including supporting greater bandwidth, to improve space segment utilization, to increase throughput and to reduce the cost of our products.

We have devoted research and development resources to development of our DialAway VSAT. This product provides inexpensive, near toll quality, dial tone telephone service for small businesses and villages in remote or urban areas lacking an adequate telecommunications infrastructure. We intend to

continue development of the DialAway VSAT to develop new features, enhance existing features and reduce costs. We have contractually agreed to commit \$4.5 million in 1999 and \$2.8 million in 2000 to the development of certain technology related to this product. This technology will be co-owned with our affiliate, GVT. See "Marketing, Distribution and Strategic Alliances—Strategic Alliances and Joint Ventures."

We have developed the SkyBlaster VSAT product and will continue development of that product in connection with our efforts in the MOST Consortium (an Israeli generic technology research consortium described below). This product is an interactive VSAT that incorporates a satellite return channel, which enables two-way access to multimedia services via the Internet. The SkyBlaster is targeted for use in communities of interest, corporations, small to mid-size businesses and small office/home office users. The SkyBlaster is designed to offer improved access through better response time and faster downloading of large files, such as audio and video clips.

GE RSD → Our research and development efforts related to a product using the technology acquired in the Spacenet acquisition are intended to increase throughput, expand product features to serve additional applications and reduce costs. Our cost-reduction efforts are focused on greater integration of components, upgradeable VSAT platforms and higher data rates.

We develop our own network software and the software for all of our VSAT product lines. We generally license our software to customers as part of the sale of our network products and services.

We regard our software and our internally developed hardware as proprietary and have implemented protective measures both of a legal and practical nature. We have obtained and registered several patents in the United States and in various other countries in which we offer our products and services. We rely upon the copyright laws to protect against unauthorized copying of the object code of our software, and upon copyright and trade secret laws for the protection of the source code of our software. We derive additional protection for our software by licensing only the object code to customers and keeping the source code confidential. In addition, we enter into standard confidentiality agreements with our customers to protect our software technology and trade secrets. We have also made copyright, trademark and service mark registrations in the United States and abroad for additional protection of our intellectual property. Despite all of these measures, it is possible that competitors could copy certain aspects of our software or hardware or obtain information which we regard as a trade secret in violation of legal protections.

We periodically receive communications asserting that our products or applications thereof infringe a third party's patent rights or copyrights. We also send similar communications to third parties which we believe may be infringing our patents. There is no pending litigation against us regarding any infringement claim.

Third-Party Funding. Through December 31, 1998, we accrued a total of approximately \$2,245,000 in grants from the Office of the Chief Scientist for the development of our OneWay VSAT products, DialAway VSAT product, and mesh satellite communication network products for voice and data. Through that date, we have repaid all the royalties we are required to repay with respect to grants for the OneWay VSAT. Under the terms of our funding from the Office of the Chief Scientist for the DialAway product, royalties of 3% to 5% are payable on sales of these products developed from the funded project, up to 100% of the dollar-linked grant received in respect of the project. Through December 31, 1998, we accrued royalties of \$697,000 to the Office of the Chief Scientist for the DialAway project. The terms of these grants prohibit the manufacture of developed OneWay products or developed DialAway products outside of Israel and the transfer of technology developed pursuant to the terms of these grants to any person without the prior written consent of the Office of the Chief Scientist. We received such consent in connection with the OneWay product for the China joint ventures and will seek consent in connection with the DialAway product for our GVT investment. These restrictions do not apply to the sale or export

from Israel of products developed with that know-how. Also, these limitations do not apply to products which have not been funded by the Office of the Chief Scientist.

Through December 31, 1998, we received or accrued grants of approximately \$1.0 million from BIRD for the development of the Skystar Advantage VSAT and FaraWay VSAT products. Under the terms of BIRD funding, generally royalties of 2.5% to 5% on sales of products whose development is so funded are payable until 150% of the dollar amount funded (linked to the Consumer Price Index of the United States) is repaid. As of December 31, 1998, we have paid or accrued to BIRD approximately \$1.7 million in royalties. As of that date, we have completed repayment of royalties to BIRD with respect to our Skystar Advantage VSAT products and our FaraWay VSAT product.

Through December 31, 1998, we received grants of approximately \$125,000 from the European Commission in connection with a joint research and development project with a number of European high technology companies for a satellite-based interactive television platform.

Research and Development Consortium Participation. In addition to royalty-bearing grants from the Office of the Chief Scientist and BIRD, we have received grants from generic research consortia, each comprised of several major high technology companies in Israel which are being partially funded by the Office of the Chief Scientist. We expect to receive further grants from those consortia that are continuing. The consortia are:

- the Israel Satellite Earth Station Generic Research and Development Consortium (devoted to basic technology research for the satellite earth stations industry) which was completed by the end of 1998;
- the Israel Advanced Digital Communication Generic Research and Development Consortium (devoted to generic technology research of advanced digital communication) which was completed by the end of 1998;
- the GaAs MMIC Consortium (devoted to generic technology research of MMIC components and advanced communications);
- the MOST Consortium (devoted to generic technology research for on-line broadband multimedia services); and
- the ISIS Consortium (devoted to generic technology research for the information superhighway in space) which began in February 1999.

In general, any member of a consortium that develops technology in the framework of that consortium retains the intellectual property rights to technology developed and all the members of the consortium have the right to utilize and implement any such technology without having to pay royalties to the developing consortium member. Transfer of consortium-developed technology or manufacturing of developed products outside of Israel is subject to restrictions and the approval of the Consortium Committee of the Office of the Chief Scientist and of the management of the consortium.

Under each of the research consortia, the Office of the Chief Scientist contributes 66% of the approved budget for that consortium and the members of the consortium contribute the remaining 34%. No royalties are payable to the Israeli Government with respect to this funding. Expenses in excess of the approved budget are borne by the consortia members. As of December 31, 1998, we have accrued approximately \$9.6 million in grants from the Office of the Chief Scientist through the consortia, including \$0.9 million for equipment.

The following table sets forth, for the years indicated, our gross research and development expenditures, the portion of such expenditures which was funded by royalty-bearing and non-royalty bearing grants, acquired research and development and the net cost of our research and development activities:

	<u>Years Ended</u> <u>December 31,</u>		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
Gross research and development costs.....	\$8,129	(dollars in thousands) \$10,615	\$15,815
Less:			
Royalty-bearing grants (the Office of the Chief Scientist And BIRD).....	(276)	(464)	(997)
Non-royalty-bearing grants (the Consortia).....	(1,637)	(2,030)	(2,038)
Acquired research and development costs.....			80,000
Research and development costs—net.....	<u>\$6,216</u>	<u>\$8,121</u>	<u>\$92,780</u>

Manufacturing and Operations

Our products are designed, assembled, manufactured and tested at our facility in Petah Tikva, Israel, except for the ISAT frame relay systems and Gilat Florida's VSAT paging products which are designed, assembled, manufactured and tested at Gilat Florida's facilities in West Melbourne, Florida.

We have network operations centers at McLean, Virginia; Marietta, Georgia; Backnang, Germany and Argentina and shared hub facilities in Chicago, Illinois; Backnang, Germany; Argentina and the Czech Republic, from which we perform network services and customer support functions 24 hours a day, 7 days a week, 365 days a year. The network operations centers allow us to perform diagnostic procedures on customer networks and to reconfigure networks to alter data speeds, change frequencies and provide additional bandwidth.

Our current manufacturing facilities have sufficient capacity to handle current demand. To provide capacity for continued growth we completed by the end of 1997 the second phase of our new facility in Israel, as well as the expansion of the Florida facilities. We have begun a third and fourth phase of construction to add approximately 93,000 square feet and 79,000 square feet, respectively; the third phase is expected to be completed by the end of 1999 and the fourth phase by the end of the first quarter of 2001. We will have additional manufacturing capacity as a result of such expanded facilities. However, we cannot assure that the expected construction schedule will be met. See Item 2: "Description of Property".

Patents and Intellectual Property

We currently rely on a combination of patent, trade secret, copyright and trademark law, together with non-disclosure agreements and technical measures, to establish and protect proprietary rights in our products. We hold a United States patent for a commercial satellite communication system that allows random access to allotted frequency segments on satellites. The patented system allows our customers to utilize lower cost networks, while maintaining sufficient throughput and response times. Through Gilat Florida, we also hold a United States patent for the ISAT frame relay system. In addition, we also hold several patents relating to spread spectrum.

We believe that our patents are important to our business. We also believe, however, that the improvement of existing products, reliance upon trade secrets and unpatented proprietary know-how as well as the development of new products are generally as important as patent protection in establishing and maintaining a competitive advantage. We believe that the value of our products is dependent upon our proprietary software and hardware remaining "trade secrets" or subject to copyright protection. Generally, we enter into non-disclosure and invention assignment agreements with our employees and subcontractors. However, we cannot assure that our proprietary technology will remain a trade secret, or that others will not develop a similar technology or use such technology in products competitive with those offered by us.

We may, from time to time, be notified of claims that we may be infringing patents, copyrights, or other intellectual property rights owned by third parties. While we do not believe we are currently infringing any intellectual property rights of third parties, we cannot assure that other companies will not, in the future, pursue claims against us with respect to the alleged infringement of patents, copyrights or other intellectual property rights owned by third parties. In addition, litigation may be necessary to protect our intellectual property rights and trade secrets, to determine the validity of and scope of the propriety rights of others or to defend against third-party claims of invalidity. Any litigation could result in substantial costs and diversion of resources and could have a material adverse effect on Gilat's business, financial condition and operating results.

We cannot assure that infringement, invalidity, right to use or ownership claims by third parties or claims for indemnification resulting from infringement claims will not be asserted in the future. If any claims or actions are asserted against us, we may seek to obtain a license under a third party's intellectual property rights. We cannot assure, however, that a license will be available under terms that are acceptable to us, if at all. The failure to obtain a license under a patent or intellectual property right from a third party for technology used by us could cause us to incur substantial liabilities and to suspend the manufacture of the product covered by the patent or intellectual property right. In addition, we may be required to redesign our products to eliminate infringement if a license is not available. Such redesign, if possible, could result in substantial delays in marketing of products and in significant costs. In addition, should we decide to litigate such claims, such litigation could be extremely expensive and time consuming and could materially adversely affect our business, financial condition and operating results, regardless of the outcome of the litigation.

Government Regulation

Regulatory Overview. The international telecommunications environment is highly regulated. As a provider of communications services in the United States, we are subject to the regulatory authority of the United States, primarily the Federal Communications Commission (the "FCC"). We are also subject to regulation by the national communications authorities of other countries in which we provide service. Each of these entities can potentially impose operational restrictions on us. The changing policies and regulations of the United States and other countries will continue to affect the international telecommunications industry. We cannot predict the impact that these changes will have on our business or whether the general deregulatory trend in recent years will continue. We believe that continued deregulation would be beneficial to us, but also could reduce the limitations facing many of our existing competitors and potential new competitors.

We are required to obtain approvals from numerous national and local authorities in the ordinary course of our business in connection with most arrangements for the provision of services. The necessary approvals generally have not been difficult for us to obtain in a timely manner. However, the failure to obtain particular approvals has delayed, and in the future may delay our provision of services. Moreover, it is possible that any approvals that may be granted may be subject to materially adverse conditions.

United States Regulation. All entities that use radio frequencies to provide communications services in the United States are subject to the jurisdiction of the FCC under the Communications Act of 1934, as amended (the "Communications Act"). The Communications Act prohibits the operation of satellite earth station facilities and VSAT systems such as those operated by us except under licenses issued by the FCC. Major changes in earth station or VSAT operations require modifications to the FCC licenses, which must also be approved by the FCC. The licenses we hold are granted for ten year terms. The FCC generally renews satellite earth station and VSAT licenses routinely, but we cannot assure that our licenses will be renewed at their expiration dates or that such renewals will be for full terms. In addition, certain aspects of our business may be subject to state and local regulation including, for example, local zoning laws affecting the installation of satellite antennas.

International Regulation. We must comply with the applicable laws and obtain the approval of the regulatory authority of each country in which we propose to provide network services or operate VSATs. The laws and regulatory requirements regulating access to satellite systems vary from country to country. Some countries have substantially deregulated satellite communications, while other countries maintain strict monopoly regimes. The application procedure can be time-consuming and costly, and the terms of licenses vary for different countries. In addition, in some countries there may be restrictions on our ability to interconnect with the local switched telephone network.

Employees

Including the staff of Spacenet, we had approximately 960 full-time employees as of May 1, 1999, including 160 employees in administration and finance, 141 employees in marketing and sales, 191 employees in engineering, research and development and 426 employees in manufacturing, operations and technical support. Of these employees, 419 were based in our facilities in Israel, 459 were employed in the United States, 60 in Europe, 20 in Asia and the Far East, and the balance in other parts of the world.

We also utilize temporary employees, as necessary, to supplement our manufacturing and other capabilities. We believe that our relations with our employees are satisfactory.

We and our employees are not parties to any collective bargaining agreements. However, certain provisions of the collective bargaining agreements between the Histadrut (General Federation of Labor in Israel) ("Histadrut") and the Coordination Bureau of Economic Organizations (including the Manufacturers' Association of Israel) are applicable to Israeli employees by order (the "Extension Order") of the Israeli Ministry of Labor and Welfare. These provisions principally concern the length of the work day and the work week, minimum wages for workers, contributions to a pension fund, insurance for work-related accidents, procedures for dismissing employees, determination of severance pay and other conditions of employment. Furthermore, pursuant to such provisions, the wages of most of our employees are automatically adjusted based on changes in the Israeli CPI. The amount and frequency of these adjustments are modified from time to time.

Israeli law generally requires severance pay upon the retirement or death of an employee or termination of employment without due cause. We currently fund our ongoing severance obligations by making monthly payments to approved severance funds or insurance policies. In addition, Israeli employees and employers are required to pay specified sums to the National Insurance Institute, which is similar to the U.S. Social Security Administration. Since January 1, 1995, such amounts also include payments for national health insurance. The payments to the National Insurance Institute are approximately 14.6% of wages (up to a specified amount), of which the employee contributes approximately 66% and the employer contributes approximately 34%. The majority of our permanent employees are covered by life and pension insurance policies providing customary benefits to employees,

including retirement and severance benefits. For Israeli employees, we contribute 13.33% to 15.83% (depending on the employee) of base wages to such plans and the permanent employees contribute 5% of base wages.

CONDITIONS IN ISRAEL

We are incorporated under the laws of, and our offices and manufacturing facilities are located in, the State of Israel. Accordingly, we are directly affected by political, economic and military conditions in Israel. Our operations would be materially adversely affected if major hostilities involving Israel should occur or if trade between Israel and its present trading partners should be curtailed.

Political and Economic Conditions

Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. However, a peace agreement between Israel and Egypt was signed in 1979, a peace agreement between Israel and Jordan was signed in 1994 and, since 1993, several agreements between Israel and Palestinian representatives have been signed. In addition, Israel and several other Arab States have announced their intention to establish trade and other relations and are discussing certain projects. As of the date hereof, Israel has not entered into any peace agreement with Syria or Lebanon. There is substantial uncertainty about how the "peace process" will develop or what effect it may have upon us.

Despite the progress towards peace between Israel, its Arab neighbors and the Palestinians, certain countries, companies and organizations continue to participate in a boycott of Israeli firms. We do not believe that the boycott has had a material adverse effect on us, but there can be no assurance that restrictive laws, policies or practices directed towards Israel or Israeli businesses will not have an adverse impact on the expansion of our business.

As discussed below, (see Item 9: "Management's Discussion and Analysis of Financial Condition and Results of Operations—Impact of Inflation and Currency Fluctuations"), the costs of our operations in Israel are generally incurred in NIS. If the inflation rate in Israel exceeds the rate of devaluation of the NIS against the dollar in any period, the costs of our Israeli operations, as measured in dollars, could increase. Israel's economy has, at various times in the past, experienced high rates of inflation.

Trade Agreements

Israel is a member of the United Nations, the International Monetary Fund, the International Bank for Reconstruction and Development and the International Finance Corporation. Israel is a signatory to the General Agreement on Tariffs and Trade, which provides for reciprocal lowering of trade barriers among its members. In addition, Israel has been granted preferences under the Generalized System of Preferences from Australia, Canada and Japan. These preferences allow Israel to export the products covered by such programs either duty-free or at reduced tariffs.

Israel and the European Union concluded a Free Trade Agreement in July 1975 that confers certain advantages with respect to Israeli exports to most European countries and obligates Israel to lower its tariffs with respect to imports from these countries over a number of years. In 1985, Israel and the United States entered into an agreement to establish a Free Trade Area ("FTA"). The FTA has eliminated all tariff and certain non-tariff barriers on most trade between the two countries. On January 1, 1993, Israel and the European Free Trade Association ("EFTA") entered into an agreement establishing a free-trade zone between Israel and the EFTA nations. In recent years, Israel has established commercial and trade relations with a number of other nations, including Russia, the People's Republic of China and nations in Eastern Europe, with which Israel had not previously had such relations.

Risk Factors; Forward-Looking Statements

The following factors, in addition to other information contained in this annual report on Form 20-F should be considered carefully.

This annual report on Form 20-F includes certain statements that are intended to be, and are hereby identified as, "forward looking statements" for the purposes of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties, and assumptions about Gilat, including, among other things:

- our anticipated growth strategies
- our intention to introduce new products
- anticipated trends in our business, including trends in the market for communication network products and services
- future expenditures for capital projects
- our ability to continue to control costs and maintain quality

These statements may be found in Item 1: "Description of Business" and Item 9: "Management's Discussion and Analysis of Financial Condition and Results of Operations," and in this annual report on Form 20-F generally. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including all the risks discussed in "Risk Factors" and elsewhere in this annual report on Form 20-F.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties, and assumptions, the forward-looking events discussed in this annual report on Form 20-F might not occur.

Integration of the newly acquired Spacenet with Gilat

On December 31, 1998, we completed the acquisition of Spacenet and its subsidiaries and certain foreign affiliates and are working towards integration with Gilat of Spacenet's facilities, personnel, research and development efforts and subsidiaries. The integration diverts substantial attention of our senior management team from Gilat's daily operation and places significant pressure on our staff and other resources. The integration poses financial, operational and legal risks, and any failure to integrate Spacenet successfully could have a material adverse effect on our business and operating results.

In addition, we face several challenges which stem from our assumption of Spacenet's product lines, services and customer base. With the acquisition of Spacenet, we are entering the satellite service business; prior to the acquisition, our business was limited to satellite equipment. Moreover, in 1997 and 1998, Spacenet was our largest customer, accounting for approximately 34% and 45% of our revenues respectively. We will need to market Spacenet products and services which are new to our operation. We will also be required to provide product support and other services to Spacenet end-users who have certain dated or non-Gilat products historically offered by Spacenet. We cannot assure that we will be able to perform these commitments successfully and on a cost-effective basis. As a result of the Spacenet acquisition, we incurred restructuring expenses of \$14.2 million for the year ended December 31, 1998 mainly for compensation to customers and other third parties, \$9.5 million of inventory write off relating to rationalization of product lines, and \$2.7 million of write off of investments associated with restructuring which have no alternative use.

We may also be unable to successfully achieve full integration of Spacenet with Gilat. Such integration may be impeded by general economic conditions, failure to integrate Spacenet's financial and operating systems, adverse response of competitors or clients, or regulatory developments. As a result, the expected operating synergies and cost savings may not be realized and Gilat's business, financial condition and operating results could be materially adversely affected.

History of losses at Spacenet

In 1996, 1997 and 1998, for periods prior to the acquisition, Spacenet reported net losses of \$3.4 million, \$18.5 million and \$3.1 million, respectively. We have, pursuant to the procedures of the Merger Agreement, objected to certain aspects of the Spacenet balance sheet as reported for 1998 which may result in adjustments showing losses higher than those reported for that year. Any such adjustments to the balance sheet would not have an impact on our business, financial condition or operating results. See Item 13: "Interest of Management in Certain Transactions - Merger Related Agreements -- Post-Closing Adjustments". Spacenet's losses can be attributed in part to the lack of adequate financial and operating controls and systems and difficulties in integrating previous acquisitions. Our success in reversing this historic trend of net losses depends on implementing cost-saving steps such as elimination of redundant overhead, implementing more rigorous operational and financial controls and focusing on a streamlined product line while growing Spacenet's sales and customer base. A new enterprise resource planning system is being implemented at Spacenet and is expected to be operational by September 1, 1999, although we can not assure that this schedule will be met. Continuation of Spacenet's net losses would have a material adverse effect on our business, financial condition and operating results.

Potential liabilities under agreements related to our merger with Spacenet

In connection with our acquisition of Spacenet, we entered into a Merger Agreement and a series of related agreements. The Merger Agreement contemplates post-closing adjustments which may require us to pay certain amounts to GE Americom or to issue additional Ordinary Shares to GE Americom. In addition, we have undertaken to indemnify GE Americom from and against certain losses which may arise from our breach of our representations and warranties and certain other obligations. See Item 13: "Interest of Management in Certain Transactions—Merger-Related Agreements."

Potential change in allocation of purchase price of Spacenet acquisition

On December 31, 1998, we recorded a charge of \$80 million for the write-off of acquired in-process research and development associated with the Spacenet acquisition (the "IPR&D Write-off"). In-process research and development expenses arise from new product development projects that are in various stages of completion at the acquired enterprise at the date of acquisition. The amount of the IPR&D Write-off is based on an independent appraiser's report obtained by management.

In-process research and development write-offs have recently been examined by the SEC. While we believe that the IPR&D Write-off is consistent with applicable accounting rules, the methods and techniques by which such rules are applied are still being developed by the accounting profession, at the guidance of the SEC. The SEC has not reviewed the IPR&D Write-off for the Spacenet acquisition. Any adjustments in the allocation to in-process research and development would result in an increase in intangible assets which would be required to be amortized over their estimated useful lives and a decrease in operating and net income for future periods which may impact on the price of the Ordinary Shares. Regardless of the outcome of any discussions regarding the IPR&D Write-off, there would be no cash impact.

If we were to reclassify a portion of the purchase price that was allocated to in-process research and development to intangible assets, for each \$10 million reclassified to intangible assets, both our intangible assets and earnings (loss) before income taxes for our 1998 fiscal year would increase

*Assume \$40m
reclass. cost;
• \$667,000 decrease
per quarter*

(decrease) by the same amount. Assuming that the intangible assets that would result from this reallocation of the purchase price had a 15 year useful life, we would report an approximately \$667,000 increase in annual amortization expense, and a \$667,000 decrease in net income before taxes, for each \$10 million reclassified.

Risks associated with new product research and development in process at Spacenet

An important part of the Spacenet acquisition was the purchase of Spacenet's ongoing research and development of advanced interactive VSAT technology. We believe that this technology represents a significant advance over currently available technology. Spacenet had been developing a product using this technology under the name of Turbosat; we plan to continue this product's research and development and to market the resulting product under our own name. However, we cannot assure that all aspects of this new technology will ever reach the feasibility stage or that if it does reach this stage, that it will be developed in time to obtain a competitive advantage. In addition, even if all of the features of the product are developed in time, we cannot assure that the product will be developed in a cost-effective manner.

Ability to manage our rapid growth and expansion

We have grown significantly in the last few years and expect to continue to grow rapidly. This growth is likely to place a significant strain on our resources and systems, as we expand our manufacturing, testing, quality control, delivery and service operations. In particular, we are in the process of implementing a new management information system to assist in managing our anticipated growth.

We cannot assure that we will be able to meet all our product delivery and service commitments or that we will be able to implement successfully the new management information system. Inability to manage our growth effectively will expose us to potential loss of customers, contractual penalties, damage to reputation and various costs and expense. This could have a material adverse effect on our business, financial condition and operating results.

Dependence on a limited number of large sales and limited number of products

A significant portion of our sales are derived from large-scale contracts with major customers. Generally, we are selected as suppliers of these customers in a bid process. The number of major bids for VSAT-based networks in any given year is limited and the competition is intense. Our losing a relatively small number of bids could have a significant adverse impact on our operating results. In addition, the USPS contract does not require the USPS to purchase any specific number of VSATs by any specific date. See Item 1: "Description of Business—Customers—USPS Transaction."

In addition, in recent years we have derived more than half of our sales from our SkyStar Advantage product. Any change in the market acceptance of this product, or of other key products such as our telephony products, could have a material adverse effect on our business.

Need to develop, introduce and market new products and services

Our market is characterized by rapid technological changes, frequent new product announcements and evolving industry standards. Significant technological changes could render our existing products and technology obsolete. To be successful, we must anticipate changes in technology and industry standards and continuously develop and introduce new products and services as well as enhancements to existing products and services. If we are unable to address the needs of our customers successfully and to respond to technological advances on a cost-effective and timely basis, or if new products are not accepted by the market, then our business, financial condition and operating results could be adversely affected.

Backlog of orders may not be filled and contracts may not be renewed

At present, we have a substantial backlog of orders, consisting of network service contracts, generally for three to five years, and of new orders for products and services. We may be unable to fill all the backlog or to fully recognize the revenues expected from this backlog for any of the following reasons:

- Existing service contracts can be terminated due to customers' dissatisfaction with the service we provide
- Existing contracts may be terminated because of our inability to timely provide and install additional products or requested new applications

The loss of existing contracts and a decrease in the number of renewals of orders or of new large orders, would have a material adverse effect on our business, financial condition and operating results. In addition, a portion of our service contracts are short-term with expiration or cancellation upon 90 days' notice or less. If a substantial number of our service customers choose to cancel or not to renew their contracts, our business could be adversely affected.

Potential delays in the supply of components required to build our VSATs

Several of the components required to build our VSATs are manufactured by a limited number of suppliers. In the past we have not experienced any difficulties with our suppliers. However, we can not assure the continuous availability of key components or our ability to forecast our component requirements sufficiently in advance. Any interruption in supply would cause delays in manufacturing and shipping products. Those delays and the cost of developing alternative sources of supply could have a material adverse effect on our business, financial condition and operating results.

Dependence on availability of satellite transponder space

Our VSAT-based services depend on satellite transponder space purchased from third-party suppliers. For networks in the United States, we primarily use satellite capacity acquired from GE Americom. We also use capacity on several regional satellites in Western and Eastern Europe, Latin America, India and other areas of Asia. In connection with our acquisition of Spacenet, we entered into a series of agreements with GE Americom. These agreements provide protected services for customer networks on transponders on three satellites currently operated by GE Americom and on one satellite to be constructed, operated and launched by GE Americom, as well as certain preemptible services for in-house use on an additional satellite operated by GE Americom. See Item 1: "Description of Business-Satellite Capacity" and Item 13: "Interest of Management in Certain Transactions—The Satellite Transponder Agreements." We cannot assure that this transponder capacity will be sufficient to meet our growing needs, or that we will be able to obtain additional transponder space at competitive prices from GE Americom or from other suppliers should we need to do so. In addition, our transponder service contracts generally do not provide for alternative services in the event of satellite failure, and we do not maintain insurance against such failures. Therefore, if a satellite becomes inoperable, and alternative services are not available, our revenues would be adversely affected.

Potential competition with existing customers

With the acquisition of Spacenet, we will be entering the VSAT service industry. As service providers, we will be competing with certain existing customers for our products who provide VSAT-related services to end-users. These customers could consequently sever their business relationships with us or, alternatively, we may elect to refrain from selling additional products to them. The loss of those

customers, some of whom may be significant, could have a material adverse effect on our business, financial condition and operating results.

Competition in the network communications industry

Gilat operates in a highly competitive industry of network communications. Many of our competitors have substantially greater financial resources, providing them with greater research and development and marketing capabilities. These competitors are also more experienced in obtaining regulatory approvals for their products and services and in marketing them. Our relative position may place us at a disadvantage in responding to our competitors' pricing strategies, technological advances and other initiatives.

Gilat's principal competitor in the supply of data networks is Hughes Network Systems ("Hughes"), which offers a full line of VSAT products and services. Hughes obtains satellite capacity on the satellite system operated by its affiliates Hughes Galaxy and PanAmSat.

The following table lists additional competitors of Gilat:

<u>Competitor</u>	<u>Area of Competition</u>
NEC Corporation	FaraWay VSAT system
Comstream Corp.	FaraWay VSAT system
ViaSat Inc.	FaraWay VSAT system
Titan Information Systems Corp.	DialAway VSAT system
STM Wireless, Inc.	DialAway VSAT system
ACT Networks, Inc.	ISAT Frame relay system
GlobeComm Systems Inc.	ISAT Frame relay system
Engineering Technical Services Inc.	ISAT Frame relay system
EF Data Corp.	Unidirectional broadcast products
SpaceCom Systems, Inc.	Unidirectional broadcast products

In addition, Gilat competes with various companies that offer communication network systems based on other non-satellite technologies such as terrestrial lines (including ISDN lines and fiber optics), frame relay, radio and microwave transmissions. These technologies can often be cheaper than VSAT technology while still providing a sufficient variety of the features required by customers. Competitors of this type include major established carriers such as AT&T, MCI Worldcom, Sprint, British Telecom, Deutsche Telekom, France Telecom, global consortia of PTTs and others.

Dependence on proprietary VSAT technology

Proprietary rights are important to our success and our competitive position. We establish and protect the proprietary rights and technology used in our products by the use of patents, trade secrets, copyrights and trademarks. We also utilize non-disclosure and invention assignment agreements.

Our actions to protect our proprietary rights may be insufficient to prevent others from developing similar products to ours. In addition, the laws of many foreign countries do not protect our intellectual property rights to the same extent as the laws of the United States.

Dependence on our key management and technical personnel

We believe that our success depends on the continued employment of the following senior management team:

<u>Name</u>	<u>Position</u>	<u>Employment Agreement</u>
Yoel Gat	Chairman and Chief Executive Officer	Year-to-year
Amiram Levinberg	President and Chief Operating Officer	Year-to-year
Yoav Leibovitch	Vice President, Finance and Administration and Chief Financial Officer	Year-to-year

If any of our key personnel is unable or unwilling to continue in his present position, our business, financial condition and operating results could be materially adversely affected.

Competition for personnel, particularly for employees with technical expertise, is intense. Our business, financial condition and operating results will be materially adversely affected if we cannot hire and retain suitable personnel.

Dependence on a single facility makes us susceptible to its condition

Most of our manufacturing capacity, our principal offices and principal research and development facilities are concentrated in a single location in Israel.

Fire, natural disaster or any other cause of material disruption in our operation in this location could have a material adverse effect on our business, financial condition and operating results. In addition, the particular risks relating to our location in Israel are described below.

Risks relating to our international sales and operations

We sell and distribute our products and also provide our services internationally, particularly in the United States, Europe and Latin America. A component of our strategy is to continue to expand into new international markets, such as China and South America. Our operations can be limited or disrupted by various factors known to affect international trade. These factors include the following:

- imposition of governmental controls and regulations
- export license requirements
- political instability
- trade restrictions and changes in tariffs
- difficulties in staffing and managing foreign operations
- longer payment cycles and difficulties in collecting accounts receivable
- seasonal reductions in business activities

Difficulties in obtaining regulatory approvals for our telecommunication services

Our telecommunication services require licenses and approvals by the FCC in the United States, and by regulatory bodies in other countries. The approval process can often take substantial time and require substantial resources, and any approvals that may be granted may be subject to materially adverse conditions. In addition, even after obtaining the required approvals the regulating agencies may, at any time, impose additional requirements. We can not assure our ability to comply with any new requirements on a timely or economic basis.

Limitation on production outside of Israel and on transfer of technology

Because some of our products were developed with Israeli governmental financial support, we cannot manufacture them or transfer the technology embodied in them outside of Israel without governmental approval. Those approvals, if granted, may be conditioned, among other things, upon significantly higher royalty payments to the Israeli government. See Item 7: "Taxation."

Fluctuations in operating results and volatility of share price

Our operating results may vary significantly from quarter to quarter. Historically, we have recognized a greater proportion of our revenues in the last quarter of each year. The causes of fluctuations include, among other things:

- the timing, size and composition of orders from customers
- our timing of introducing new products and product enhancements and the level of their market acceptance
- the mix of products and services we offer
- the changes in the competitive environment in which we operate

The market price of our Ordinary Shares has been subject to volatility and could be subject to wide fluctuations in response to numerous factors, many of which are beyond our control. These factors include the following:

- actual fluctuations or anticipated variations in our operating results
- announcements of technological innovations
- customer orders or new products or contracts
- competitors' positions in the market
- changes in financial estimates by securities analysts
- conditions and trends in the VSAT and other technology industries
- our earnings releases and the earning releases of our competitors
- the general state of the securities markets (with particular emphasis on the technology and Israeli sectors thereof)

In addition, the stock market in general, and the market for technology companies in particular, has been highly volatile. Investors may not be able to resell their shares following periods of volatility.

The trading prices of many technology-related companies' stocks have recently reached historical highs and have reflected relative valuations substantially above historical levels. These trading prices may not be sustained.

Potential of litigation due to intellectual property infringements

From time to time we receive communications asserting that our products or their applications infringe on a third party's proprietary rights. Currently, there is no pending litigation against us regarding any intellectual property claim, and we do not believe that we are infringing on any other party's rights, but we cannot assure that there will not be future claims. Such claims, with or without merit, could subject us to costly litigation and divert our technical and management personnel from their regular responsibilities. Furthermore, successful claims could suspend the manufacture of products using the contested invention, and have a material adverse effect on our business, financial condition and operating results.

Potential product liability claims

We may be subject to legal claims relating to the products we sell or the services we provide. Our agreements with our customers generally contain provisions designed to limit our exposure to potential product liability claims. We also maintain a product liability insurance policy. Our insurance may not cover all relevant claims or may not provide sufficient coverage. To date, we have not experienced any material product liability claims. Our business, financial condition and operating results could be materially adversely affected if costs resulting from future claims are not covered by our insurance or exceed our coverage.

Concentration of control over Gilat

GE Americom beneficially owns approximately 23.84% of our outstanding Ordinary Shares as of June 16, 1999. GE Americom and several other principal shareholders, who beneficially own (including options exercisable within 60 days) an additional approximately 10.11% of our Ordinary Shares, have entered into a shareholders' agreement. As a result of this agreement, a group of our principal shareholders, collectively owning only about 33.95% of our outstanding Ordinary Shares, is able to exercise effective control over most of our business. For a review of the shareholders' agreement including certain exceptions to the above, see Item 13: "Interest of Management in Certain Transactions—The Shareholders' Agreement." In addition, Israeli law requires a minimum 75% of the shareholders to approve certain significant corporate changes, including merger and consolidation. Consequently, subject to the terms of the Shareholders' Agreement, GE Americom could block approval of such resolutions.

No intention to pay dividends

We have never paid cash dividends on our Ordinary Shares and do not anticipate paying any cash dividends in the foreseeable future. We intend to retain any earnings for use in our business. In addition, the terms of some of our financing arrangements restrict us from paying dividends to our shareholders.

Availability of Israeli Government benefits to our company

Under the Israeli Law for Encouragement of Capital Investments, 1959, facilities that meet certain conditions can apply for an "Approved Enterprise" status. This status confers certain benefits including tax benefits. All of our existing facilities have been designated as "Approved Enterprises." Our historical operating results reflect substantial tax benefits which amount to approximately \$1,592,000, \$3,872,000 and \$341,000 for 1996, 1997, and 1998, respectively.

In addition, under the Law for Encouragement of Research and Development, 1984, we have received research and development grants from the Office of the Chief Scientist of the Ministry of Trade and Industry of the State of Israel (the "Office of the Chief Scientist"). These grants are repayable from royalties on sales of products developed with these grants. Under the terms of the grants, we are required to manufacture these products in the State of Israel unless we receive a permit from the Office of the Chief Scientist to manufacture abroad. If we receive a permit to manufacture abroad, we may be required to pay a higher royalty rate on sales of these products, and we may also be required to repay a greater overall amount. In addition, we have received grants from research consortia that are partly funded by the Office of the Chief Scientist. The consortia grants do not require the payment of royalties.

During 1996, 1997 and 1998, we accrued \$1,950,000, \$2,494,000 and \$2,910,000, respectively in royalty-bearing and non-royalty-bearing grants from the Office of the Chief Scientist.

The Government of Israel has indicated its intention to reexamine its policies in these areas. The Israeli Government has also shortened the period of the tax exemption applicable to "Approved Enterprises" from four years to two years. This change only applies to our last three "Approved Enterprises" and to any future "Approved Enterprises" if any. See Item 1: "Description of Business—Research and Development; Third-Party Funding."

With respect to repayment of grants from the Office of the Chief Scientist, in 1997, the Government increased the annual rate of royalties from between 2% to 3% of associated product sales to between 3% and 5% of associated product sales (including service and other related revenues). Israeli authorities have also indicated that the grant program may be further reduced in the future.

We cannot be sure that these and other governmental programs and tax benefits will be continued in the future at their current levels or at all. The termination or reduction of the benefits available to us would significantly increase our costs and could have a material adverse effect on our business, financial condition and operation results. See Item 7: "Taxation."

In addition, in order to maintain our eligibility for the grants and tax benefits we receive, we must continue to meet certain conditions, including making certain investments in fixed assets and operations. If we fail to meet such conditions in the future, we could be required to refund tax benefits already received, with interest and linkage differences to the Israeli Consumer Price Index (the "Israeli CPI").

Impact of inflation and foreign currency fluctuations

Our international sales expose us to fluctuations in foreign currencies. Substantially all of our sales are denominated in US dollars. Conversely, a significant portion of our expenses, mainly salaries, is incurred in NIS and is linked to the Israeli CPI. When the Israeli inflation rate exceeds the rate of the NIS devaluation against the foreign currencies, then our NIS expenses increase to the extent of the difference between the rates. A significant disparity of this kind may have a material adverse effect on our operating results.

Risks relating to our location in Israel

We are incorporated under the laws of the State of Israel, where we also maintain our headquarters and most of our manufacturing facilities. Political, economic and military conditions in Israel directly influence us. Since the establishment of the State of Israel in 1948, Israel and its Arab neighbors have engaged in a number of armed conflicts. A state of hostility, varying in degree and intensity, has led to security and economic problems for Israel. Despite the progress towards peace between Israel and its Arab neighbors and the Palestinians, major hostilities may revive. Such hostilities may hinder Israel's international trade and lead to economic downturn. This, in turn, could have a material adverse effect on our operations and business.

Generally, male adult citizens and permanent residents of Israel under the age of 51 are obligated to perform 14 to 31 days of military reserve duty annually, depending on their age. Additionally, all such residents are subject to being called to active duty at any time under emergency circumstances. The full impact on our workforce or business if some of our officers and employees are called upon to perform military service is difficult to predict. See "Conditions in Israel."

Year 2000 compliance

The Year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. In other words, date-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in system failures or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices or engage in similar normal business activities. Furthermore, vendors who provide critical infrastructure services (e.g., electricity, water, telephone) or other critical services (e.g. sub-assemblies, outsourcing of manufacturing and parts) may encounter Year 2000 problems.

We may realize exposure and risk if the systems on which we are dependent to conduct our operations or the vendors on whose services we are dependent are not Year 2000 compliant. Our potential areas of exposure include certain products purchased from third parties, computers, software, telephone systems and other equipment used internally. In addition, certain of the older VSAT platforms installed by Spacenet may not be Year 2000 compliant and may require upgrading or replacement. We do not expect the cost of such upgrades or replacements to be material.

We are currently in the process of developing our computer software applications and systems to accommodate Year 2000 compliance. To date, we have undertaken a program to identify all our critical systems and suppliers. We have assessed these in terms of Year 2000 readiness and we have identified those requiring replacement or remediation. Our remediation or replacement program is planned to be completed by year end.

We have already spent on Year 2000 compliance approximately \$300,000 and expect to spend approximately another \$325,000 by year end 1999. The cost of upgrades or replacements, while significant, is not expected to be material to our financial position or results of operations. The funds necessary for achieving Year 2000 compliance are part of our working capital.

As indicated, as part of this program, we are currently conducting an analysis to determine the extent to which key distributors, vendors and suppliers have Year 2000 issues. This is being accomplished by receiving written responses from our critical distributors, vendors and suppliers in which they indicate their Year 2000 readiness. We cannot assure that all necessary upgrades or replacements can be successfully identified and completed on time or that the systems of the vendors on whose services we are dependent are properly certified as being Year 2000 compliant. If our present efforts to address the Year 2000 compliance issues are not successful, or if distributors, suppliers and other third parties with which we conduct business do not successfully address such issues, our business, financial condition and operating results could be materially and adversely affected.

The Merger Agreement relating to our acquisition of Spacenet required us to develop a schedule for achieving Year 2000 compliance by June 30, 1999 (with certain limited exceptions). This schedule was prepared and submitted to GE Americom and we are currently in the process of providing them with updates as to the status of the program.

Uncertainty of enforceability of civil liabilities against foreign persons

Our directors and officers and the Israeli experts named in this annual report on Form 20-F reside outside the United States. Service of process upon them may be difficult to effect within the United States. Furthermore, because the majority of our assets are located in Israel, any judgment obtained in the United States against us or any of our directors and officers may not be collectible within the United States.

ITEM 2: DESCRIPTION OF PROPERTY

In April 1996, we moved to approximately 62,000 square feet of office, manufacturing and warehousing facilities in Petah Tikva, Israel, which was expanded by an additional 57,000 square feet at the end of 1997. We purchased approximately 93,000 square feet of additional facilities in 1997 for a contract price of approximately \$17.4 million, including taxes and related expenses. We have paid a majority of the purchase price, with the remainder to be paid during construction, which is expected to be completed at the end of 1999. We have also exercised our contractual option to acquire approximately 79,000 square feet of space, including parking and commercial space, at a price of approximately \$16.6 million including taxes and related expenses. Preliminary construction has begun and is expected to be completed by the end of the first quarter 2001. In addition we have (i) purchased 34,120 square feet of additional space in an adjoining building, at a price of approximately \$3.2 million; and (ii) acquired an additional 65,000 square feet of adjoining real property for future expansion.

We currently maintain a 7,500 square foot facility in Yokneam, Israel for software research and development at a monthly rental of \$4,650; the lease is for five years, with an option for an additional five years.

The current facility of Gilat Florida in West Melbourne, Florida houses the Gilat Florida executive, sales, manufacturing, and research and development activities, under a ten-year lease which began May 1, 1997 at a current monthly rental of approximately \$15,938.

Our offices in McLean, Virginia comprise approximately 70,000 square feet. These offices house not only our personnel, but also contain one of our U.S. network operations centers. The lease covering these facilities expires in April 2005. We also lease a facility in Marietta, Georgia comprising approximately 70,000 square feet, which is used for certain assembly and repair functions and a second Gilat U.S. network operations center as well as space in Manassas, Virginia, Chicago, Illinois and Houston, Texas for sales and operations personnel and for equipment storage. Our European business leases a 21,000 square foot facility in Backnang, Germany, which is used by our European-based management, sales and operations personnel and contains our European network operations center. We maintain offices in Tulsa, Oklahoma, Atlanta, Georgia, Paris and Hong Kong, and in South America, in Brazil, Argentina, Colombia and Mexico, along with representative offices in Beijing and in Thailand and we also lease office space in London, Prague, Amstelveen, São Paulo, Buenos Aires and New Delhi, and small facilities in other locations.

Petah Tikva office, mfg., & warehousing space:

April 96	62,000	
Dec 97	+ 57,000	
97	+ 93,000	
	+ 34,120	49
<hr/>		
246,120 sq. ft.		
250,000 sq. ft.		

Yokneam software R&D:

7,500 sq. ft.

ITEM 3: LEGAL PROCEEDINGS

We are a party to various legal proceedings incident to our business, most of which were assumed in our acquisitions and are still the subject of various indemnities obtained in such acquisitions. Except as noted below, there are no material legal proceedings pending or, to our knowledge, threatened against us or our subsidiaries, and we are not involved in any legal proceedings that our management believes, individually or in the aggregate, would have a material adverse effect on our business, financial condition or operating results.

In March 1999, we settled an arbitration proceeding brought by Shanghai V-Tech Telecommunications Systems Co., Ltd. ("V-Tech"), an affiliate of GTS TeleSystems Group, Inc. ("GTS") in connection with the purchase of VSAT equipment for a system in China.

On January 4, 1999, Gilat Satellite Networks Inc. was named as a defendant in an action filed in the Circuit Court for Montgomery County, Maryland entitled *Hughes Network Systems v. David Shiff, Sheldon Revkin, and Gilat Satellite Networks, Inc.* Plaintiff Hughes Network Systems seeks to enjoin Sheldon Revkin and David Shiff from working for Gilat in its Spacenet operations, and to enjoin Gilat from employing them for a limited period of time. The amended complaint alleges misappropriation of trade secrets and interference with commercial relations and seeks unspecified damages. On January 14, 1999, Judge William Turner of the Circuit Court signed an temporary order forbidding Revkin and Shiff from divulging any of Hughes' technical trade secrets, but denied plaintiff's request for an order enjoining Revkin and Shiff from doing their jobs for Gilat. We have filed a motion to dismiss the amended complaint and for attorney fees. We do not believe the proceedings will prevent Messrs. Shiff and Revkin from performing their roles at Spacenet or that any judgment will have a material adverse impact on our business, financial condition or operating results.

We are also a party to various regulatory proceedings incident to our business. To the knowledge of our management, none of such proceedings is material to us or to our subsidiaries.

ITEM 4: CONTROL OF REGISTRANT

as of
June 16, 1999

The following table sets forth certain information with respect to the beneficial ownership of our Ordinary Shares as of June 16, 1999 (including options exercisable within 60 days) with respect to: (i) each person who is believed by us to be the beneficial owner of more than 5% of the Ordinary Shares; and (ii) all directors and officers as a group. Except where otherwise indicated, we believe, based on information furnished by the owners, that the beneficial owners of the Ordinary Shares listed below have sole investment and voting power with respect to such shares, subject to any applicable community property laws.

<u>Name and Address</u>	<u>Number of Ordinary Shares Beneficially Owned</u>	<u>Percent of Ordinary Shares Outstanding</u>
GE Americom(1) 3135 Flaston Turnpike Fairfield, Connecticut 06431-0001	5,000,000	23.84
Pilgrim Baxter & Associates(2) 825 Duportail Road Wayne, PA 19087	1,183,600	5.64
Wellington Management Company, LLP(2) 75 State Street Boston, Massachusetts 02109 All officers and directors as a group (18 persons)(3)	1,634,490 1,212,766	7.79 5.78

- (1) Excludes 292,699 Ordinary Shares held indirectly by General Electric Company through various subsidiary companies, including mutual funds and pension trusts managed by General Electric Company.
- (2) Based on information available to Gilat.
- (3) Includes 340,390 Ordinary Shares for which options to 15 executive officers are currently exercisable within 60 days but have not yet been exercised, but does not include 182,418 Ordinary Shares held by DIC Financial Management Ltd. ("DICFM") of which Dov Tadmor (a current Director of Gilat) may be deemed a beneficial owner. Mr. Tadmor disclaims beneficial ownership of such shares. PEC Israel Economic Corporation ("PEC"), a Maine corporation, and DICFM, an Israeli corporation, are controlled by Discount Investment Corporation Ltd. ("DIC"), which is in turn controlled by IDB Development Corporation Ltd. ("IDBD"). Companies controlled by Dina Recanati, Elaine Recanati, Leon Y. Recanati and Judith Yovel Recanati, together beneficially own approximately 51.6% of the equity and voting power in IDB Holding Corporation Ltd. ("IDBH"), the parent of IDBD. Dina Recanati and Elaine Recanati are sisters-in-law and the aunts of Leon Y. Recanati and Judith Yovel Recanati, who are brother and sister. Leon Y. Recanati is co-Chairman of the Board of Directors and co-Chief Executive Officer of IDBH and co-Chairman of the Board of Directors of IDBD. Based on the foregoing, IDBH and IDBD (by reason of their control of DIC), DIC (by reason of its control of PEC and DICFM) and Dina Recanati, Elaine Recanati, Leon Y. Recanati and Judith Yovel Recanati, may be deemed to share with PEC and DICFM the power to vote and dispose of the Ordinary Shares held by such companies. For information with respect to a voting agreement and shareholders agreement entered into by certain shareholders, see Item 13: "Interest of Management in Certain Transactions."

ITEM 5: NATURE OF THE TRADING MARKET

Our Ordinary Shares are quoted on the Nasdaq National Market under the symbol "GILTF." The following table sets forth, for the periods indicated, the range of high and low closing sale price for the Ordinary Shares, as reported by Nasdaq:

	<u>High</u>	<u>Low</u>
1996:		
First Quarter	\$28.875	\$22.125
Second Quarter	\$24.250	\$19.500
Third Quarter	\$22.250	\$16.250
Fourth Quarter	\$26.500	\$17.250
1997:		
First Quarter	\$36.500	\$26.625
Second Quarter	\$36.750	\$27.000
Third Quarter	\$37.063	\$31.250
Fourth Quarter	\$40.500	\$27.000
1998:		
First Quarter	\$36.500	\$22.500
Second Quarter	\$39.250	\$30.500
Third Quarter	\$46.125	\$32.313
Fourth Quarter	\$56.375	\$37.500
1999:		
First Quarter	\$63.000	\$52.250
Second Quarter (to June 22)	\$60.750	\$47.875

As of June 16, 1999 there were 104 record holders of Ordinary Shares, of which 94 represented U.S. record holders owning an aggregate of approximately 95.5% of the outstanding Ordinary Shares.

We have never paid cash dividends to our shareholders and we currently do not intend to pay dividends for the foreseeable future. We intend to reinvest earnings in the development and expansion of our business. We have decided to reinvest permanently the amount of tax exempt income derived from our "Approved Enterprises" and not to distribute such income as dividends. See Note 10 of Notes to the Consolidated Financial Statements listed in Item 19. We may only pay cash dividends in any fiscal year out of "profits," as determined under Israeli law. In addition, the terms of certain financing arrangements restrict us from paying dividends to our shareholders.

In the event we declare dividends in the future, we will pay those dividends in NIS. Because exchange rates between NIS and the dollar fluctuate continuously, a U.S. shareholder will be subject to currency fluctuation between the date when the dividends are declared and the date the dividends are paid.

ITEM 6: EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

Non-residents of Israel who purchase any of our Ordinary Shares with certain non-Israeli currencies (including the dollar) and through an authorized foreign currency dealer bank will be able to convert dividends, liquidation distributions and the proceeds from the sale of such Ordinary Shares into freely repatriable non-Israeli currencies at the rate of exchange prevailing at the time of conversion (provided that Israeli Income Tax has been paid or withheld on such amounts).

ITEM 7: TAXATION

Nonresidents of Israel are subject to income tax on income accrued or derived from sources in Israel or received in Israel. These sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. Gilat is required to withhold income tax at the rate of 25% (15% for dividends generated by an Approved Enterprise) on all distributions of dividends other than bonus shares (stock dividends), unless a different rate is provided in a treaty between Israel and the shareholder's country of residence. Under the income tax treaty between the United States and Israel (the "Treaty"), the maximum tax on dividends paid to a holder of Ordinary Shares who is a United States resident (as defined in the Treaty) is 25%.

Israeli law imposes a capital gains tax on the sale of securities and other capital assets. Under current law, however, gains from sales of the Ordinary Shares of Gilat are exempt from Israeli capital gains tax for so long as (i) the shares are quoted on Nasdaq or listed on a stock exchange recognized by the Israeli Ministry of Finance and (ii) Gilat qualifies as an Industrial Company or Industrial Holding Company under the Law for Encouragement of Industry (Taxes), 1969. Furthermore under the Treaty, a holder of Ordinary Shares who is a United States resident will be exempt from Israeli capital gains tax on the sale, exchange or other disposition of such Ordinary Shares unless such holder owns, directly or indirectly, 10% or more of the voting power of Gilat.

A nonresident of Israel who receives interest, dividend or royalty income derived from or accrued in Israel, from which tax was withheld at the source, is generally exempt from the duty to file tax returns in Israel with respect to such income, provided such income was not derived from a business conducted in Israel by the taxpayer.

Israel presently has no estate or gift tax.

ITEM 8: SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data of Gilat gives retroactive effect to the acquisition of Spacenet which has been accounted for as a purchase. The selected consolidated statement of operations data set forth below with respect to the years ended December 31, 1994, 1995, 1996, 1997 and 1998 and the consolidated balance sheet data as of December 31, 1994, 1995, 1996, 1997 and 1998 have been prepared in accordance with Israel GAAP and U.S. GAAP (as applied to Gilat's financial statements, such accounting principles are practically identical) and audited by Kesselman & Kesselman, independent certified public accountants in Israel and a member of Pricewaterhousecoopers International Limited. The selected consolidated financial data set forth below should be read in conjunction with Item 9: "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and Notes thereto included in Item 19 in this Form 20-F.

YEARS ENDED DECEMBER 31,

	1994 ⁽¹⁾	1995 ⁽¹⁾	1996 ⁽¹⁾	1997	1998
(In thousands, except per share data)					
Statement of Operations Data:					
Sales	\$37,924	\$54,532	\$74,126	\$103,690	\$155,335
Cost of sales:					
Cost of products sold	21,403	31,483	42,917	58,742	86,603
Write-off of inventories associated with restructuring					9,495
	<u>21,403</u>	<u>31,483</u>	<u>42,917</u>	<u>58,742</u>	<u>96,098</u>
Gross profit.....	<u>16,521</u>	<u>23,049</u>	<u>31,209</u>	<u>44,948</u>	<u>59,237</u>
Research and development costs:.....					
Expenses incurred	4,148	6,532	8,129	10,615	15,815
Less-grants.....	<u>1,397</u>	<u>1,066</u>	<u>1,913</u>	<u>2,494</u>	<u>3,035</u>
	2,751	5,466	6,216	8,121	12,780
Acquired research and development.....					80,000
Net research and development costs.....	<u>2,751</u>	<u>5,466</u>	<u>6,216</u>	<u>8,121</u>	<u>92,780</u>
Selling, general and administrative expenses	<u>7,047</u>	<u>9,544</u>	<u>13,945</u>	<u>20,321</u>	<u>29,077</u>
	6,723	8,039	11,048	16,506	(62,620)
Restructuring charges					14,239
Merger expenses			7,991		
Operating income (loss).....	6,723	8,039	3,057	16,506	(76,859)
Financial income (expenses)—net.....	(105)	575	1,170	538	(1,247)
Write-off of investments associated with restructuring					(2,700)
Other income (expenses)—net.....	(1)		1,329	30	162
Income (loss) before taxes on income.....	6,617	8,614	5,556	17,074	(80,644)
Taxes on income	<u>139</u>		<u>84</u>	<u>130</u>	<u>286</u>
Income (loss) after taxes on income.....	6,478	8,614	5,472	16,944	(80,930)
Share in losses of associated companies					703
Net income (loss)	<u>\$6,478</u>	<u>\$8,614</u>	<u>\$5,472⁽²⁾</u>	<u>\$16,944</u>	<u>(\$1,633)</u>
Earnings(loss) per share:					
Basic.....	<u>\$0.72</u>	<u>\$0.92</u>	<u>\$0.51⁽²⁾</u>	<u>\$1.56</u>	<u>(\$7.38)⁽²⁾</u>
Diluted.....	<u>\$0.71</u>	<u>\$0.89</u>	<u>\$0.50⁽²⁾</u>	<u>\$1.51</u>	<u>(\$7.38)⁽²⁾</u>
Weighted average number of shares used in computation of earnings (loss) per share — in thousands.....					
Basic.....	<u>9,097</u>	<u>9,413</u>	<u>10,816</u>	<u>10,895</u>	<u>11,059</u>
Diluted.....	<u>9,071</u>	<u>9,632</u>	<u>11,049</u>	<u>11,255</u>	<u>11,059</u>

Balance Sheet Data:	DECEMBER 31,				
	1994	1995	1996	1997	1998
	(In thousands)				
Working capital.....	\$21,144	\$61,623	\$61,632	\$85,081	\$68,694
Total assets.....	45,215	97,423	112,201	211,960	410,284
Short-term bank credit and current Maturities of long-term debt.....	1,205	4,806	582	2,719	23,158
Long-term debt.....	1,500	13	-	75,000	75,000
Shareholders' equity.....	35,471	81,563	89,758	108,338	220,370

⁽¹⁾ Includes the results of Gilat Florida into which a wholly-owned subsidiary of Gilat was merged on December 30, 1996, and accounted for pursuant to the pooling-of-interests method.

⁽²⁾ If the merger expenses associated with the Gilat Florida Merger had not been included in Gilat's results, net income for the year ended December 31, 1996 would have been approximately \$13,463,000 and basic earnings per share for that year would have been \$1.24 and diluted earnings per share would have been \$1.22.

⁽³⁾ If the restructuring charges, write offs associated with restructuring and expenses related to acquired research and development associated with the Spacenet Acquisition had not been included in Gilat's results, net income for the year ended December 31, 1998 would have been approximately \$24,801,000 and basic earnings per share for that year would have been \$2.24 and diluted earnings per share would have been \$2.14.